



STATE OF NORTH CAROLINA

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

CHAPEL HILL, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2009

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

CHAPEL HILL, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2009

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Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Beverly E. Perdue, Governor
The General Assembly of North Carolina
Board of Trustees, The University of North Carolina at Chapel Hill

We have completed a financial statement audit of The University of North Carolina at Chapel Hill for the year ended June 30, 2009, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

The results of our tests disclosed no deficiencies in internal control over financial reporting that we consider to be material weaknesses in relation to our audit scope or any instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

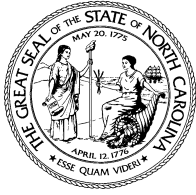
North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
The University of North Carolina at Chapel Hill
Chapel Hill, North Carolina

We have audited the accompanying financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2009, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of The Medical Foundation of North Carolina, Inc., The Educational Foundation Scholarship Endowment Trust, and The University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc., the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of The Medical Foundation of North Carolina, Inc., The Educational Foundation Scholarship Endowment Trust, and The University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc. were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The University of North Carolina at Chapel Hill and its discretely presented component units as of June 30, 2009, and the respective changes in financial position and cash flows, where


INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 17 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* and Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, during the year ended June 30, 2009.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 8, 2009 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Beth A. Wood, CPA
State Auditor

December 8, 2009

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

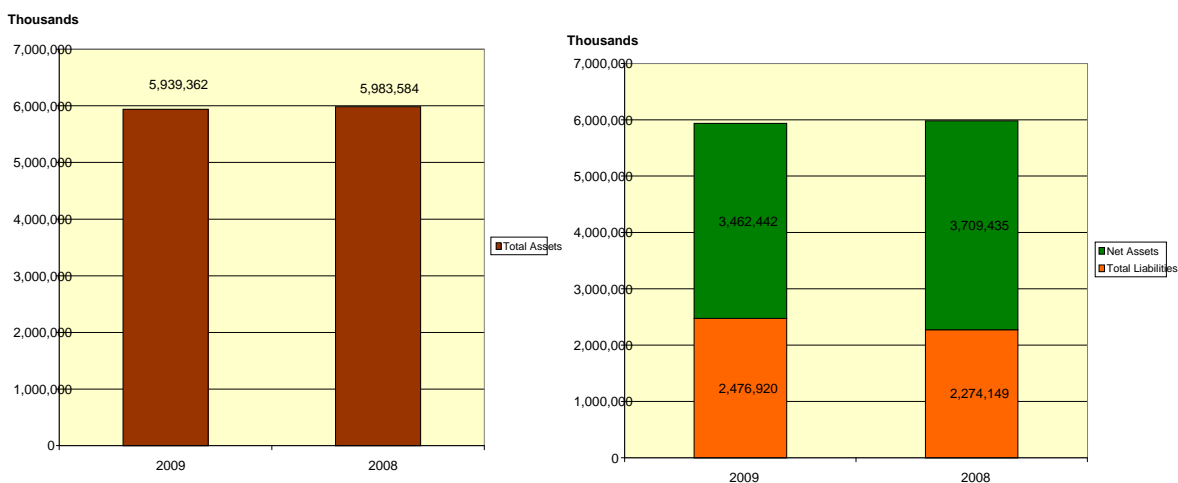
Management's Discussion and Analysis provides an overview of the financial position and activities of The University of North Carolina at Chapel Hill (the "University") for the fiscal year that ended June 30, 2009, with comparative information for the fiscal year ended June 30, 2008. Management has prepared the discussion and analysis to be read in conjunction with the financial statements and accompanying notes to the financial statements.

The University is a constituent institution of the multi-campus University of North Carolina System (UNC System), a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report (CAFR)*. The financial reporting entity for the financial statements is comprised of the University and 10 component units. Seven component units are reported as if they were part of the University, and three are reported as discretely presented component units based on the nature and significance of their relationship to the University. The reader may refer to Note 1A for detail information on the financial reporting entity.

Financial Highlights

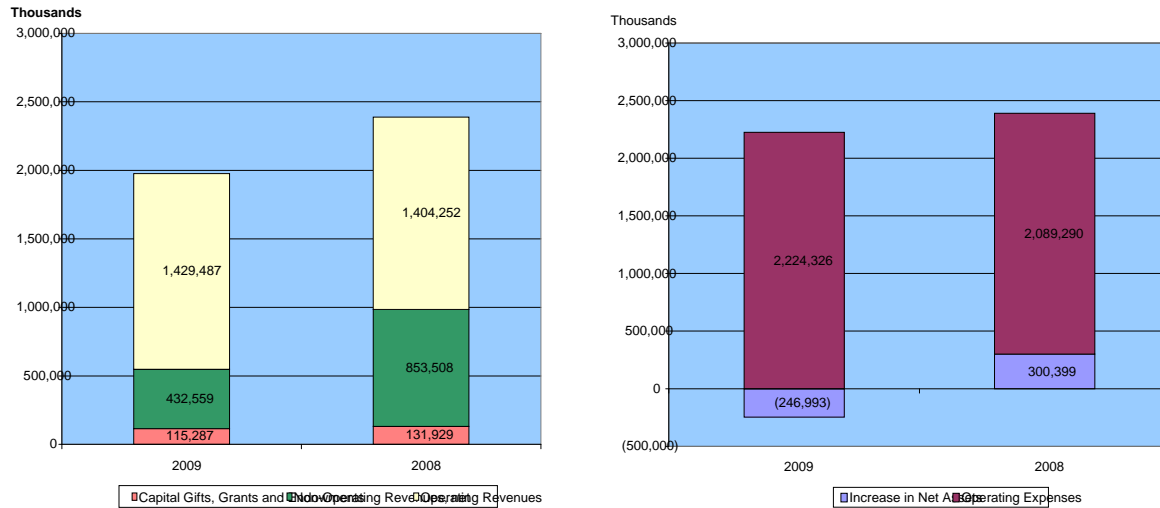
The University's financial position at June 30, 2009 was impacted by the global economic downturn as the State's revenues were below budgeted levels and the financial markets incurred negative investment returns. Higher education was not immune from the national economic crises, and the University initiated spending reductions and other measures to address the shortages in resources. The University's proactive decisions helped mitigate the impacts of the financial shortfalls. The University's total assets were \$5.9 billion at June 30, 2009. Net assets, which represent the residual interest in the University's assets after deducting liabilities, were \$3.5 billion at June 30, 2009. The University's net assets decreased by \$247 million in fiscal year 2008-2009 as a result of operating, nonoperating, and other changes in net assets. A comparison of the total assets, liabilities, and net assets at June 30, 2009 and June 30, 2008, and a comparison of the major components of the changes in net assets for the two fiscal years are presented below:

Statement of Net Assets



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Statement of Revenue, Expenses, and Changes, in Net Assets



Net assets decreased 6.7% on June 30, 2009 over the prior year. Total assets decreased 0.7% from the prior year and total liabilities rose 8.9% for the same period. Operating revenues increased at a lower rate than operating expenses in fiscal year 2008-2009 over the prior year, 1.8% and 6.5%, respectively. Net nonoperating revenues and expenses decreased 49.3% in fiscal year 2008-2009 over the prior year, due primarily to the substantial decline in investment income from \$146.7 million in fiscal year 2007-2008 to \$(296.9) million in 2008-2009. Research funding, fund raising for operational and capital needs, and construction funding through the North Carolina Higher Education Bond Referendum of 2000 continued to provide important resources to the University.

Using the Financial Statements

The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB), which establishes standards for external financial reporting for public colleges and universities. The financial statements are presented on a consolidated basis to focus on the University as a whole. The full scope of the University's activities is considered to be a single business-type activity and accordingly, is reported within a single column in the basic financial statements.

The University's Annual Financial Report includes the following three financial statements.

- Statement of Net Assets
- Statement of Revenues, Expenses, and Changes in Net Assets
- Statement of Cash Flows

Management's Discussion and Analysis provides information regarding the Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Statement of Net Assets

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year, includes all assets and liabilities of the University and segregates the assets and liabilities into current and noncurrent components. Net assets represent the difference between total assets and total liabilities and are one indicator of the University's current financial condition. The following table summarizes the University's assets, liabilities, and net assets on June 30, 2009 and June 30, 2008.

Assets, Liabilities, and Net Assets (Dollars in Thousands)	2009	2008	% Change
Assets:			
Current Assets	\$ 1,126,655	\$ 1,200,432	(6.1)
Noncurrent Assets:			
Endowment, Restricted, and Other Investments	2,058,756	2,277,442	(9.6)
Capital Assets, Net	2,530,951	2,289,015	10.6
Other Noncurrent Assets	223,000	216,695	2.9
Total Assets	5,939,362	5,983,584	(0.7)
Liabilities:			
Current Liabilities	423,124	372,616	13.6
Noncurrent Liabilities:			
Funds Held in Trust for Pool Participants	940,560	781,049	20.4
Long-Term Liabilities	1,082,197	1,088,637	(0.6)
Other Noncurrent Liabilities	31,039	31,847	(2.5)
Total Liabilities	2,476,920	2,274,149	8.9
Net Assets:			
Invested in Capital Assets, Net of Related Debt	1,338,833	1,290,034	3.8
Restricted	1,423,329	1,747,431	(18.5)
Unrestricted	700,280	671,970	4.2
Total Net Assets	\$ 3,462,442	\$ 3,709,435	(6.7)

Current Assets and Liabilities

The Statement of Net Assets shows that working capital, which is current assets less current liabilities, was \$703.5 million at June 30, 2009, a decrease of 15%, or \$124.3 million, over the previous year. While the working capital decline results from many factors, two significant changes were an increase of \$47.1 million in short-term debt used as bridge financing for capital construction and a decrease of \$96.7 million in short-term investments. The Statement of Net Assets details the current asset and current liability categories.

Endowment, Restricted, and Other Investments

Endowment investments decreased 22.4% during 2008-2009 and were \$1.15 billion at June 30, 2009 and \$1.49 billion at June 30, 2008, and include permanent endowments, funds internally designated as endowments, and similar funds such as gift annuities and charitable trusts. Net assets of endowment and similar funds were \$1.13 billion at June 30, 2009, and \$1.46 billion for the prior year.

The endowment assets are invested with The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. ("Investment Fund"), which is reported as a governmental

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

external investment pool in the financial statements. The Investment Fund is a 501(c)(3) nonprofit corporation established to support the University by operating an investment pool for charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. It is expected that all or substantially all of the assets of the Investment Fund will be invested in the UNC Investment Fund, LLC (System Fund), which began functioning as a pooled investment fund effective January 1, 2003.

The investment objective is to earn an average real total return of at least 5.5% per year, net of all fees, over rolling five- and 10-year periods. The earnings distribution policy is to provide a stable source of spending support that is sustainable over the long term while preserving the purchasing power of the endowment investments. The earnings distribution rate was established at 5% of the previous year's market value, with annual increases based on inflationary factors. Each year's distribution is subject to a 4% floor and a 7% cap based on estimated fiscal year-end market value.

Restricted investments for external pool participants of \$819.1 million at June 30, 2009 include funds of affiliated entities that are neither part of the University's reporting entity nor reported discretely but do invest through the System Fund. Other investments include bond reserves and related funds of \$86.6 million.

Most of the University's endowment investments are currently managed within the System Fund, a pooled investment fund vehicle. Fiscal year 2008-2009 clearly represented the most difficult investment environment for college and university endowments in more than a generation.

The System Fund is designed to provide long-term, stable rates of return (CPI plus 5.5%) on the invested assets through the use of a diversified portfolio strategy. As reported by UNC Management Company, Inc., the manager of the System Fund, the investment return on the endowment assets invested in the Fund for fiscal year 2008-2009 was (19.6)%. The respective returns for fiscal years 2007-2008 and 2007-2006 were 8.0% and 23.4%.

The System Fund's (19.6)% return for fiscal year 2008-2009 lagged the (17.1)% return on the Strategic Investment Policy Portfolio (SIPP) benchmark by 2.5 percentage points. The SIPP is a blended portfolio benchmark that represents a weighted average of the appropriate market benchmarks for the Fund's strategic asset classes. The 70/30 "traditional" domestic benchmark is comprised of 70% invested in the S&P 500 equity index and 30% in the Barclay's Aggregate bond index also returned (17.1)% in fiscal year 2008-2009.

The investment performance resulted in the System Fund earning a three-year annualized return of 2.3% at June 30, 2009. This three-year return measure compares with the corresponding measure of (0.1)% for the SIPP and (3.7)% for the 70/30 benchmark. For the five years ended June 30, 2009, the System Fund earned 8.1% annualized return compared to 5.3% for the SIPP and the 0.1% for the 70/30 benchmark.

A policy for the University Statutory Endowment was approved to address the provisions of the Uniform Prudent Management of Institutional Funds Act, which was adopted by the State

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

of North Carolina in March 2009. The market values for 194 of the 1,036 endowments had fallen below book value; and the actual, annual earnings distribution from the University Statutory Endowment was subsequently reduced by 9.6%, or \$5 million, from the calculated earnings distribution to avoid any principal invasion.

The policy indicates that campus departments shall examine the endowment-supported activity for upcoming fiscal year for possible deferment of program expenses, and then pursue alternative funding for essential activities, and finally shall consult with donors regarding other funding options for program support. Invasion of endowment principal is an option of last resort and will only be done consistent with approved limitations to preserve the endowment principal's value.

Capital Assets and Debt Management

An essential aspect for enhancing and maintaining the University's academic, research, and service programs and its residential life is the development and renewal of its capital assets. The University Board of Trustees approved the campus master plan in March 2001 to guide the University's physical development in the 21st Century. The master plan and subsequent modifications mesh the critical pieces needed for smart growth in the 21st Century - transportation, parking, housing, utilities, and sustainability - with the program needs of a growing campus. The master plan combines the practical requirements of a research university with the beauty that inspired its founders. The University expects continued growth in the future, including advancing plans for Carolina North, a satellite campus on property about two miles north of main campus.

A summary of changes in capital assets is disclosed in Note 5. Capital assets, net of accumulated depreciation, at June 30, 2009 and June 30, 2008, were as follows:

<u>Capital Assets (Dollar In Thousands)</u>	<u>2009</u>	<u>2008</u>	<u>Change</u>
Construction in Progress	\$ 614,308	\$ 665,936	(7.8)
Land and Other Nondepreciable Assets	146,428	115,155	27.2
Buildings	1,425,456	1,184,264	20.4
General Infrastructure	207,171	212,514	(2.5)
Machinery and Equipment	137,588	111,146	23.8
Total	<u>\$ 2,530,951</u>	<u>\$ 2,289,015</u>	10.6

The University is engaged in a \$2.3 billion capital construction program that began in 2000 and will continue through the next few years. The 167 projects in the capital program include major capital renewal of existing buildings and infrastructure to address both deferred maintenance and programmatic needs. The 103 completed projects total \$1.1 billion, or 48% of the \$2.3 billion capital construction program. The 24 projects under construction total \$633 million or 27%, and the 40 projects under design represent \$577 million or 25%. Capital funds resulting from North Carolina Higher Education Bonds have provided essential resources for construction. The University is directly investing in its capital construction program using a variety of other funding sources including general revenue bonds, cost reimbursements from research grants, internal reserves, and private gifts.

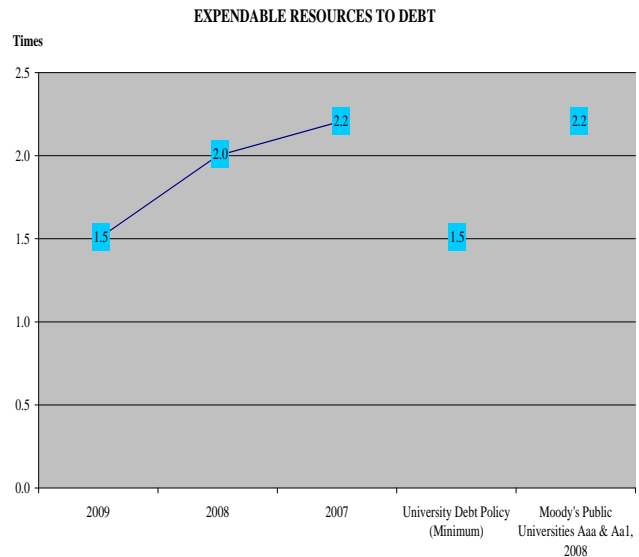
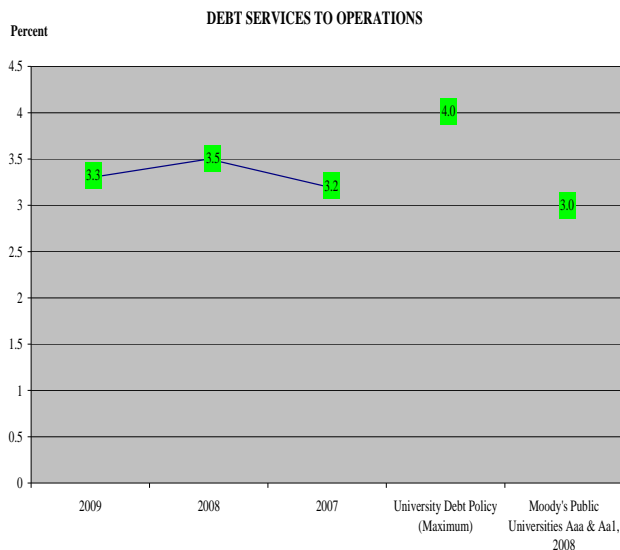
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The University continues to use its commercial paper program to provide low-cost bridge financing for capital projects until gifts are received or in anticipation of an external bond issue. Commercial paper debt was \$148.3 million at June 30, 2009 and \$101.2 million at June 30, 2008. The University currently plans to issue a long-term bond during fiscal year 2009-2010 to refund a significant portion of outstanding commercial paper and to provide additional funds for capital projects.

The University maintains a combination of variable and fixed rate debt, consistent with its debt management policy. The interest rate on the commercial paper program for fiscal year 2008-2009 was 1.20% and for 2007-2008 was 3.19%. Interest rates on the University's variable rate, long-term bonds were 1.20% for fiscal year 2008-2009 and 2.84% for fiscal year 2007-2008. Interest rates on fixed rate, long-term bonds are disclosed in Note 8B of the financial statements. These rates reflect direct interest rates and do not reflect any impact from the interest rate swaps as referenced in Note 8C.

The University's debt policy uses two key ratios to measure debt capacity, financial health, and credit quality. The *expendable resources to debt ratio* measures unrestricted, expendable restricted, and temporarily restricted net assets to funded debt and serves as a relative indicator of financial health or cushion. The *debt service to operations ratio* provides an indicator of the University's ability to repay annual principal and interest relative to its overall operating expenses. Each ratio is compared to the University's debt policy standard and the appropriate peer group comparison for fiscal year 2007-2008 (the latest available numbers). The debt policy floor for the *expendable resources to debt ratio* is 1.5 times, the debt policy ceiling for the *debt service to operations ratio* is 4%.

The University maintains long-term bond ratings of Aa1/AA+/AA+ from Moody's Investor Services, Standard & Poor's, and Fitch Ratings, respectively.



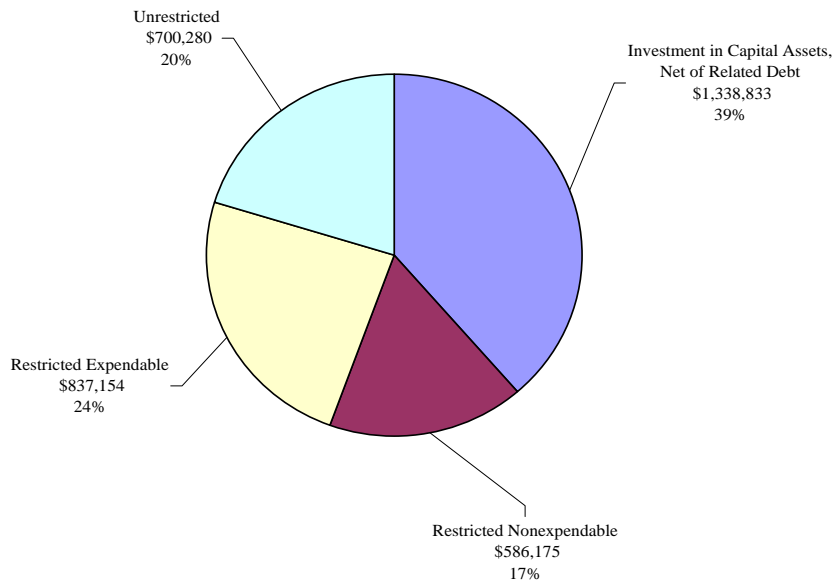
Other Noncurrent Assets and Liabilities

Other noncurrent assets were \$223 million at June 30, 2009 and \$216.7 million at June 30, 2008, a 2.9% increase. Noncurrent liabilities were \$2.1 billion at June 30, 2009 and \$1.9 billion at June 30, 2008, and include funds held in trust for the University's affiliated foundations and other campuses in the UNC System and their affiliates of \$940.6 million and \$781 million, respectively. These entities are not part of the University's financial reporting entity and are not discretely presented, but the entities do invest through the System Fund. The increase in funds held in trust of 20.4% over the prior year resulted from additional participant contributions and new participants in the System Fund.

Net Assets

Net assets represent the value of the University's assets after liabilities are deducted. The University's net assets were \$3.5 billion at June 30, 2009, a decrease of \$247 million over the prior year. Net assets invested in capital assets, net of related debt, represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included. Nonexpendable restricted net assets include endowment and similar assets whose use is limited by donors or other outside sources and as a condition of the gift, the principal is to be maintained in perpetuity. Expendable restricted net assets include resources in which the University is legally obligated to spend the resources in accordance with restrictions provided by external parties. Unrestricted net assets are not subject to externally imposed stipulations; however, most of these resources have been designated for particular academic, research, or other programs, as well as capital projects.

**2009 NET ASSETS: \$3,462,442
(IN THOUSANDS)**



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Statement of Revenues, Expenses, and Changes in Net Assets

The Statements of Revenues, Expenses, and Changes in Net Assets present the University's results of operations. The statements for the fiscal year ended June 30, 2009 and the prior year are summarized as follows:

University Operations (Dollars in Thousands)

	2009	2008	% Change
Operating Revenues:			
Student Tuition and Fees, Net	\$ 236,960	\$ 218,763	8.3
Grants and Contracts	624,420	614,513	1.6
Sales and Services, Net	559,471	564,078	(0.8)
Other	8,636	6,898	25.2
Total Operating Revenues	1,429,487	1,404,252	1.8
Operating Expenses	2,224,326	2,089,290	6.5
Operating Loss	(794,839)	(685,038)	16.0
Nonoperating Revenues (Expenses):			
State Appropriations and State Aid	538,327	543,292	(0.9)
Noncapital Gifts and Grants	241,242	216,026	11.7
Investment Income (Loss)	(296,904)	146,650	(302.5)
Interest and Fees on Debt	(52,465)	(53,311)	(1.6)
Other Net Nonoperating Revenues	2,359	851	177.2
Income Before Other Changes	(362,280)	168,470	(315.0)
Capital Grants and Appropriations	36,346	60,091	(39.5)
Capital Gifts	34,686	11,596	199.1
Additions to Permanent Endowments	44,255	60,242	(26.5)
Increase (Decrease) in Net Assets	(246,993)	300,399	(182.2)
Net Assets – July 1	3,709,435	3,409,036	8.8
Net Assets – June 30	\$ 3,462,442	\$ 3,709,435	(6.7)

*Fiscal year 2008-2009 revenues and other changes total \$2,326,702 and expenses total \$2,573,695.
Fiscal year 2007-2008 revenues and other changes total \$2,443,000 and expenses total \$2,142,601.*

Operating Revenues

The operating revenues represent resources generated by the University in fulfilling its instruction, research, and public service missions. Student tuition and fees are reported net of the scholarship discount, which was \$63.5 million for fiscal year 2008-2009 and \$57.1 million for the prior year. Net revenues from student tuition and fees increased 8.3% over the prior year. Tuition rates increased for fiscal year 2008-2009 by 6.5% for undergraduate non-residents, 8.7% for graduate residents, and 4.3% for graduate non-residents. Tuition rates for undergraduate residents did not change.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Revenues from noncapital grants and contracts increased 8.5% over the prior year when operating and nonoperating sources are combined. Discussion of grants and contracts in terms of awards provides another useful perspective. The University is among the nation's leading public research universities, with a diversified portfolio of research that attracted \$716.2 million in sponsored program funding during fiscal year 2008-2009, a 5.6% increase over the previous year total of \$678.2 million. As federal funding for research stalls and competition for investment from other sources increases, the University was able to sustain growth in awards.

The contracts and grants come primarily from the federal government, especially the National Institutes of Health (NIH) and the National Science Foundation. The NIH is traditionally the University's largest source of research funding. The University's continuing success in attracting outside contract and grant awards for research was an important and positive factor on the revenue side of the University's budget, especially given the current economic downturn. Another positive trend was the strong performance by the University's faculty in attracting new federal research funding as part of the American Recovery and Reinvestment Act (ARRA). Although ARRA awards comprise only a small portion of the fiscal year 2008-2009 awards, the University will pursue additional ARRA funding over the next two fiscal years.

The School of Medicine attracted the largest proportion of such funding at \$349.6 million, or 48.8% of the University's total. Amongst individual departments and University-based centers and institutes, the Carolina Population Center had the highest research awards total, at \$54.2 million. Other top-performing University units include the Gillings School of Global Public Health with an increase of 54% to \$97 million, the School of Information and Library Science with an increase of 572% to \$7.7 million, the Eshelman School of Pharmacy with an increase of 22% to \$20.2 million, and the School of Dentistry with an increase of 25% to \$13.5 million. The Vice Chancellor Research and Economic Development area increased 8% to \$133.7 million.

Sales and services include the revenues of campus auxiliary operations such as student housing, student stores, student health services, the utilities system, and parking and transportation, as well as revenues from patient services provided by the professional health-care clinics. Other revenues represent operating resources not separately identified and include, for example, an assessment to the Investment Fund to support University administrative services.

Operating Expenses

The University's operating expenses were \$2.2 billion for the fiscal year ended June 30, 2009, an increase of 6.5% over the prior year. The operating expenses are reported by natural classification in the financial statements and by functional classification in the notes to the financial statements (Note 11). The following table illustrates the University's operating expenses by functional classification and by natural classification:

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Operating Expenses by Nature (Dollars in Thousands)

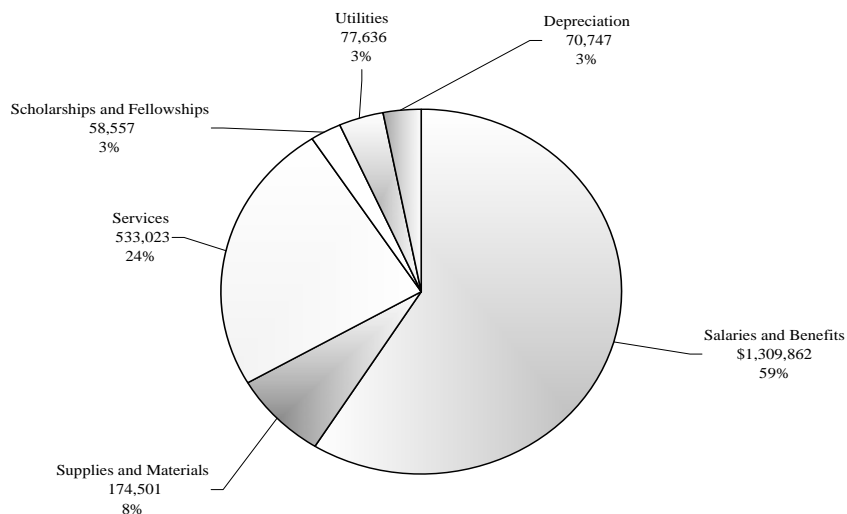
	2009	2008	% Change
Salaries and Benefits	\$ 1,309,862	\$ 1,210,757	8.2
Supplies and Materials	174,501	161,219	8.2
Services	533,023	526,646	1.2
Scholarships and Fellowships	58,557	58,058	0.9
Utilities	77,636	66,197	17.3
Depreciation	70,747	66,413	6.5
Total Operating Expenses	\$ 2,224,326	\$ 2,089,290	6.5

Operating Expenses by Function (Dollars in Thousands)

	2009	2008	% Change
Instruction	\$ \$674,942	\$ \$662,228	1.9
Research	398,754	358,199	11.3
Public Service	126,427	95,618	32.2
Academic Support	107,371	106,613	0.7
Student Services	27,967	28,434	(1.6)
Institutional Support	89,954	86,549	3.9
Operations and Maintenance of Plant	145,550	133,031	9.4
Student Financial Aid	58,557	58,058	0.9
Auxiliary Enterprises	524,057	494,147	6.1
Depreciation	70,747	66,413	6.5
Total Operating Expenses	\$ \$2,224,326	\$ \$2,089,290	6.5

The following graph illustrates the University's operating expenses by the natural classification.

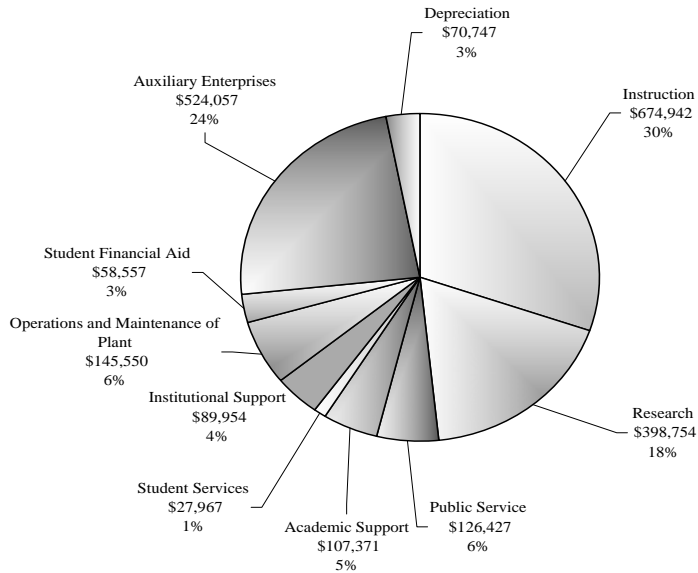
**2009 OPERATING EXPENSES BY NATURE: \$2,224,326
(IN THOUSANDS)**



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The following graph illustrates the University's operating expenses by function.

**2009 OPERATING EXPENSES BY FUNCTION: \$2,224,326
(IN THOUSANDS)**



Operating expense categories changed at varying rates. Expenses for utilities for fiscal year 2008-2009 were impacted by significant increases in fuel costs such as coal and also by a number of new University buildings that came online. Research expenses increased in keeping with the growth in sponsored awards. An objective of the University Cancer Research Fund is to accelerate progress in cancer prevention, early detection, and effective treatment; and community service efforts resulted in an increase in public service expenses.

Nonoperating Revenues and Expenses

State appropriations, noncapital gifts and grants, and investment income are considered nonoperating because they were not generated by the University's principal, ongoing operations. For example, State appropriations were not generated by the University but were provided to help fund operating expenses.

State appropriations, when including State aid of \$20.1 million, totaled \$538.3 million for fiscal year 2008-2009, a decrease of 0.9% from the prior year. The University received increases in State appropriations totaling \$17.5 million to fund salary and benefit enhancements, \$15.9 million for additional student enrollment and program enhancements, and \$2.8 million for operating costs for new facilities. The reductions in State appropriations for fiscal year 2008-2009 totaled \$41.2 million. These decreases in nonoperating revenues from State appropriations resulted from State budget reductions and restrictions on the cash allotted to the University by the State of North Carolina. The reduced State appropriations required limitations on expenses that were achieved by a temporary restriction on

MANAGEMENT’S DISCUSSION AND ANALYSIS (CONTINUED)

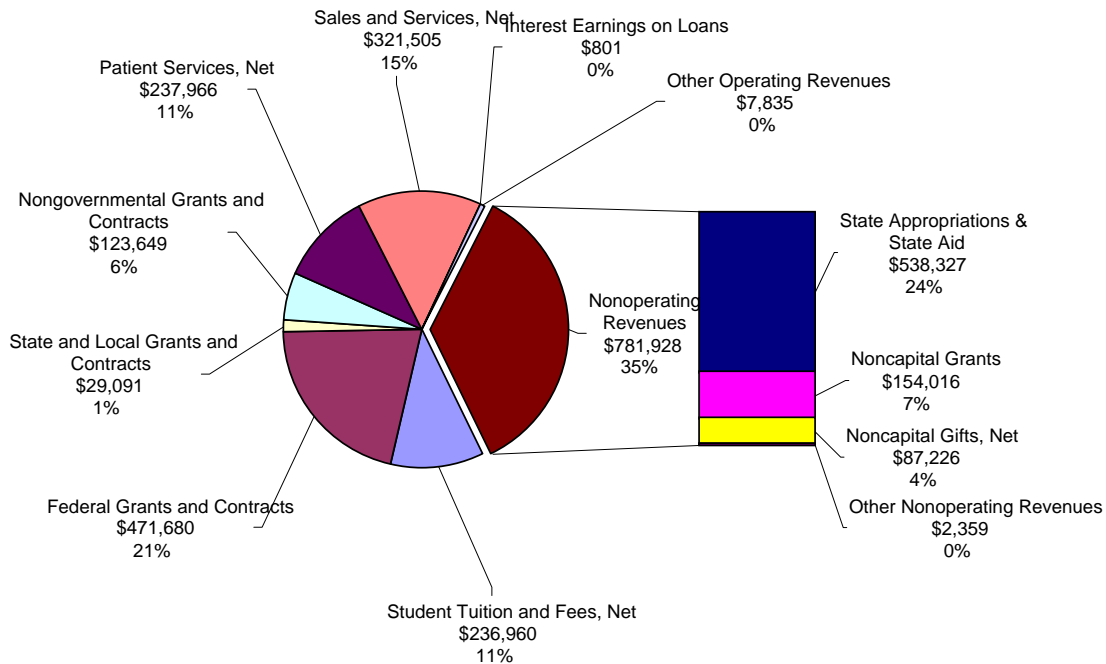
employment of new, non-instructional staff, constraints on non-personnel expenses, and implementation of a 0.5% salary reduction for faculty and staff for fiscal year 2008-2009.

Noncapital gifts and grants increased 11.7% to \$241.2 million and include expendable gifts and federal awards that are not considered to be operating revenues. Net investment income from fiscal year 2008-2009 of \$(296.9) million, a significant decrease from 2007-2008, includes income and realized and unrealized gains and is net of realized and unrealized losses and investment management fees. For additional discussion, the reader may refer to the Endowment and Other Investments section of the Management’s Discussion and Analysis.

Total Operating and Nonoperating Revenues

Operating and nonoperating revenues such as State appropriations, noncapital grants, noncapital gifts, and investment income are used to fund University operations. The following chart illustrates the University’s operating and nonoperating revenues, which total \$2.2 billion for fiscal year 2008-2009.

**2009 TOTAL REVENUES BY SOURCE: \$2,211,415
(In Thousands)**



Other Changes in Net Assets

Capital grants and appropriations of \$36.3 million for fiscal year 2008-2009 and \$60.1 million for fiscal year 2007-2008 are from statewide higher education bond proceeds and State appropriations for capital construction projects. These resources decreased as other resources are used and the pace of new constructions lessens. Capital gifts of \$34.7 million for fiscal year 2008-2009 and \$11.6 million for the prior year resulted from fund-raising efforts and

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

also provided funding for construction projects. Nonexpendable gifts and funds from the State's program to match gifts for distinguished professorship endowments resulted in additions to permanent endowments of \$44.3 million during fiscal year 2008-2009 and \$60.2 million during fiscal year 2007-2008.

Economic Outlook

The economic downturn during fiscal year 2008-2009 will also impact University resources for fiscal year 2009-2010. The University's fiscal state declined during fiscal year 2008-2009, but its overall financial condition is solid. The University will continue to maintain and generate sufficient resources to successfully fulfill its teaching, research, and service missions. Decisions to curtail or eliminate expenses have consistently protected the academic core from significant resource limitations. The University maintains low tuition levels in relative terms that provide important resources. Support from the State declined due to the economic downturn, but in relative terms higher education in North Carolina is soundly funded. Sponsored awards are a proven and reliable source in support of the University's research mission, philanthropic efforts continue to demonstrate success in a challenging environment, and invested funds provide an important distribution of earnings despite the declines in the global financial markets. The University's strong debt credit ratings of Aa1 and AA+ allow it to obtain competitive financing for capital construction.

Tuition rates increased for fiscal year 2009-2010 by 4.3% for undergraduate residents, 5.6% for undergraduate non-residents, 8% for graduate residents, and 2.1% for graduate non-residents. The University's academic standing allows it to continuously attract top students. For the first-year class enrolling for the Fall 2009 semester, 79.6% graduated in the top 10% of their class. The University's *CAFR* Statistical Section includes historical data for important metrics including the ratio of *accepted applications as a percentage of total applications* and the ratio of *enrolled students as a percentage of accepted applications*.

The University has benefited from the historically strong support that public higher education receives from the Governor and General Assembly. These are extraordinary economic times, and the global financial crisis and its ripple effects created uncharted territory in many respects. Despite the economic challenges, the projected funding level for State appropriations for fiscal year 2009-2010 totals \$536.9 million, which represents a decrease of 0.3% over fiscal year 2008-2009 actual State appropriations. This projected level of State appropriations funding includes a 5% limitation of \$28.6 million in the cash allotted to the University. The 5% limitation is a cautionary action by the Governor given the current economic environment and may be restored later in fiscal year 2009-2010.

The projected funding level of \$536.9 million is also net of required budget reductions of 7%, or \$39.3 million. In implementing the budget reductions, the University has strived to protect the academic core and instructional programs and also reviewed campus operations to identify additional efficiencies to generate savings. General administrative support units on campus incurred reductions in budgeted State appropriations of 10% in order to minimize budget reductions for academic units. Academic support and related administrative areas incurred reductions of 6.7% and instructional units incurred reductions of 5.2% on average. Significant reductions in budgeted State appropriations for centers and institutes were

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

mandated by legislative action and resulted in a budget reduction of 17.6% for the research and economic development area. While academic programs were appropriately protected in allocating the reduction in State appropriations, the University recognizes the increased focus necessary to ensure compliance and reporting requirements are met as well as daily administrative functions.

The projected funding level of \$536.9 million for State appropriations included an increase of \$6 million for enrollment increases and program enhancements. The fiscal year 2008-2009 pay increase of 3% for faculty and 2.75% for staff was the fifth consecutive year of base salary increases for all employees. There were no State appropriations provided for pay increases for fiscal year 2009-2010.

External funding from contracts and grants increased to \$716.2 million in fiscal year 2008-2009. The federal research funding as part of the American Recovery and Reinvestment Act (ARRA) supports new and ongoing research at the University that will help jumpstart the State and national economies by creating jobs in addition to expanding our knowledge about diseases, human health, and the environment. Since March of 2009 University researchers have received notifications about nearly 60 grants or awards totaling more than \$20 million from virtually every major agency in the National Institutes of Health (NIH), as well as the National Science Foundation. That total doesn't yet include a five-year, \$17.5 million grant for a solar energy consortium from the U.S. Department of Energy that started in August 2009.

The University's ARRA awards also include new NIH biomedical research and training initiatives that involve hiring high school and college students and teachers to spend their summers in University laboratories and medical facilities doing hands-on, cutting-edge research with top scientists. The University's early success in securing federal economic stimulus funding also reflects the growing ability of the faculty's expertise in multidisciplinary research, which attracts new contracts and grants despite the challenging budget climate. This strength has been a positive aspect of the University's financial picture while the campus copes with taking its share of budget reductions in State appropriations.

The University's investment management operation is separately organized as the UNC Management Company, Inc. (UNCMC), the nonprofit corporation organized and operated as a 501(c)(3) entity, to provide investment management services and administrative services to the University and to the other campuses of the UNC System and their affiliated nonprofit foundations as appropriate. This structure provides the ability to attract and retain investment professionals and increase the pool of funds and resulting investment returns. As of June 30, 2009, the UNCMC managed invested assets of \$2.2 billion. Although the course the financial markets will take this fiscal year and beyond is not known, the UNCMC will manage the funds in a highly diversified manner to capture a fair share of the upside in asset classes that are strengthening while, more importantly, providing downside protection in periods of declining markets. The focus remains on the core mission of identifying the most attractive intermediate-to-long-term investment opportunities while also remaining highly aware of the elevated risks in the current financial environment.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

Fund-raising has been a cornerstone resource for the University, and in a down economy becomes even more vital. The University's fund-raising efforts brought in \$271.25 million in gifts in fiscal year 2008-2009. The total represented the University's second highest year in history for this type of support, funds that are immediately available to the University. Including pledges as well as gifts, the University raised \$290.4 million in commitments. Commitments in fiscal year 2008-2009 helped the University create 21 endowed professorships, as well as a total of 86 undergraduate scholarships and graduate fellowships. The University had more than 75,000 donors for the fiscal year.

The University will continue to provide excellent teaching, research, and public service endeavors provided to students, citizens, and other constituents. Management has taken action to restructure and reduce the operating budget while protecting the academic foundation. Through prudent planning by management, most of the 300 positions being abolished were vacant. A policy to manage any shortfalls in endowment earnings was implemented, and some slowdowns in capital spending have been initiated. University operations were reviewed during fiscal year 2008-2009 to identify ways to streamline processes and be more effective. Some actions have been taken, and additional strategies are being assessed and an implementation plan is under development. The University's remains committed to sound financial and budgetary planning, protection and enhancement of its endowed and physical assets, as well as its observance of compliance and control standards.

The University of North Carolina at Chapel Hill
Statement of Net Assets
June 30, 2009

Exhibit A-1

ASSETS

Current Assets:	
Cash and Cash Equivalents	\$ 386,531,355
Restricted Cash and Cash Equivalents	330,973,825
Short-Term Investments	107,673,223
Restricted Short-Term Investments	94,830,921
Receivables, Net (Note 4)	177,473,726
Due from State of North Carolina Component Units	2,204,498
Inventories	22,980,867
Notes Receivable, Net (Note 4)	3,793,101
Other Assets	193,915
	<hr/>
Total Current Assets	1,126,655,431
	<hr/>
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	143,832,681
Receivables, Net (Note 4)	30,133,673
Restricted Due from Primary Government	6,673,891
Endowment Investments	1,153,045,145
Restricted Investment for External Pool Participants	819,088,465
Other Investments	86,622,629
Notes Receivable, Net (Note 4)	34,039,251
Investment in Joint Venture	8,318,917
Capital Assets - Nondepreciable (Note 5)	760,735,930
Capital Assets - Depreciable, Net (Note 5)	1,770,215,275
	<hr/>
Total Noncurrent Assets	4,812,705,857
	<hr/>
Total Assets	5,939,361,288
	<hr/>

LIABILITIES

Current Liabilities:	
Accounts Payable and Accrued Liabilities (Note 6)	116,363,522
Due to Primary Government	3,909,926
Due to State of North Carolina Component Units	4,668,792
Deposits Payable	1,080,924
Funds Held for Others	617,538
Unearned Revenue	36,351,781
Interest Payable	4,318,008
Short-Term Debt (Note 7)	148,291,000
Long-Term Liabilities - Current Portion (Note 8)	107,522,144
	<hr/>
Total Current Liabilities	423,123,635
	<hr/>
Noncurrent Liabilities:	
U. S. Government Grants Refundable	31,039,068
Funds Held in Trust for Pool Participants	940,560,485
Long-Term Liabilities (Note 8)	1,082,196,532
	<hr/>
Total Noncurrent Liabilities	2,053,796,085
	<hr/>
Total Liabilities	2,476,919,720
	<hr/>

The University of North Carolina at Chapel Hill
Statement of Net Assets
June 30, 2009

Exhibit A-1

Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	1,338,832,577
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	118,347,053
Research	17,129,137
Library Acquisitions	27,785,904
Endowed Professorships	272,397,658
Departmental Uses	103,820,068
Loans	16,731,389
Other	29,963,465
Expendable:	
Scholarships and Fellowships	158,008,483
Research	27,324,887
Library Acquisitions	43,315,889
Endowed Professorships	256,813,161
Departmental Uses	275,676,990
Instruction and Education Agreements	15,559,111
Plant Improvements	19,497,388
Capital Projects	32,173,663
Debt Service	8,785,000
Unrestricted	<u>700,279,745</u>
Total Net Assets	<u>\$ 3,462,441,568</u>

The accompanying notes to the financial statements are an integral part of this statement.

***The University of North Carolina at Chapel Hill
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2009***

Exhibit A-2

REVENUES

Operating Revenues:	
Student Tuition and Fees, Net (Note 10)	\$ 236,960,221
Patient Services, Net (Note 10)	237,966,115
Federal Grants and Contracts	471,680,201
State and Local Grants and Contracts	29,091,332
Nongovernmental Grants and Contracts	123,648,616
Sales and Services, Net (Note 10)	321,505,004
Interest Earnings on Loans	800,613
Other Operating Revenues	7,834,742
	<hr/>
Total Operating Revenues	1,429,486,844

EXPENSES

Operating Expenses:	
Salaries and Benefits	1,309,861,747
Supplies and Materials	174,501,377
Services	533,022,475
Scholarships and Fellowships	58,557,246
Utilities	77,635,759
Depreciation	70,747,110
	<hr/>
Total Operating Expenses	2,224,325,714
	<hr/>
Operating Loss	(794,838,870)

NONOPERATING REVENUES (EXPENSES)

State Appropriations	518,276,506
State Aid-Federal Recovery Funds	20,050,854
Noncapital Grants - Federal Student Financial Aid	10,169,434
Other Noncapital Grants	143,846,330
Noncapital Gifts, Net (Note 10)	87,226,074
Investment Loss (Net of Investment Expense of \$5,979,916)	(296,904,284)
Interest and Fees on Debt	(52,465,168)
Other Nonoperating Revenues	2,358,899
	<hr/>
Net Nonoperating Revenues	432,558,645

Loss Before Other Revenues, Expenses, Gains, or Losses (362,280,225)

Capital Appropriations	12,539,260
Refund of Prior Years Capital Appropriations	(3,317,088)
Capital Grants	27,123,666
Capital Gifts	34,686,235
Additions to Endowments	44,254,559
	<hr/>
Decrease in Net Assets	(246,993,593)

NET ASSETS

Net Assets - July 1, 2008	<hr/> 3,709,435,161
Net Assets - June 30, 2009	<hr/> \$ 3,462,441,568

The accompanying notes to the financial statements are an integral part of this statement.

The University of North Carolina at Chapel Hill
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2009

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 1,422,710,135
Payments to Employees and Fringe Benefits	(1,298,000,541)
Payments to Vendors and Suppliers	(751,496,170)
Payments for Scholarships and Fellowships	(58,557,246)
Loans Issued	(5,186,410)
Collection of Loans	5,101,523
Other Receipts	6,416,923
	<hr/>
Net Cash Used by Operating Activities	(679,011,786)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	518,276,506
State Aid (Federal Recovery Funds)	20,050,854
Noncapital Grants (Federal Student Financial Aid)	10,169,434
Noncapital Grants	162,063,262
Noncapital Gifts	96,695,368
Additions to Permanent Endowments	44,254,559
Federal Family Education Loans Receipts	123,877,274
Federal Family Education Loans Disbursements	(124,342,802)
Related Activity Agency Receipts	1,050,009,944
Related Activity Agency Disbursements	(694,376,277)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	1,206,678,122

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	69,702,507
Capital Appropriations	12,539,260
Refund of Prior Years Capital Appropriations	(3,317,088)
Capital Grants	38,714,228
Capital Gifts	3,345,989
Acquisition and Construction of Capital Assets	(287,565,273)
Principal Paid on Capital Debt and Leases	(56,988,407)
Interest and Fees Paid on Capital Debt and Leases	(49,407,228)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(272,976,012)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	808,040,563
Investment Income	48,583,965
Purchase of Investments and Related Fees	(1,039,722,010)
	<hr/>
Net Cash Used by Investing Activities	(183,097,482)

Net Increase in Cash and Cash Equivalents	71,592,842
Cash and Cash Equivalents - July 1, 2008	789,745,019
	<hr/>
Cash and Cash Equivalents - June 30, 2009	\$ 861,337,861

The University of North Carolina at Chapel Hill
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2009

Exhibit A-3
Page 2

**RECONCILIATION OF NET OPERATING REVENUES (EXPENSES)
TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES**

Operating Loss	\$ (794,838,870)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	70,747,110
Allowances, Write-Offs, and Amortizations	7,068,427
Changes in Assets and Liabilities:	
Receivables (Net)	5,325,082
Inventories	408,616
Notes Receivable, Net	(806,632)
Accounts Payable and Accrued Liabilities	33,358,709
Due to Primary Government	(3,363,795)
U.S. Government Grants Refundable	(807,764)
Unearned Revenue	(4,290,099)
Compensated Absences	8,187,430
Net Cash Used by Operating Activities	<u>\$ (679,011,786)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 386,531,355
Restricted Cash and Cash Equivalents	330,973,825
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	<u>143,832,681</u>
Total Cash and Cash Equivalents - June 30, 2009	<u>\$ 861,337,861</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through a Gift	\$ 31,340,246
Assets Acquired through the Assumption of a Capital Lease	84,205
Change in Fair Value of Investments	(347,452,242)
Loss on Disposal of Capital Assets	(6,306,862)

The accompanying notes to the financial statements are an integral part of this statement.

The University of North Carolina at Chapel Hill
Statement of Financial Position
June 30, 2009

Exhibit B-1

	UNC-CH Arts and Sciences Foundation, Inc.	The Educational Foundation Scholarship Endowment Trust	The Medical Foundation of North Carolina, Inc.
ASSETS			
Cash and Cash Equivalents	\$ 8,705,738	\$ 10,309,655	\$ 48,786,870
Investments		149,483,378	63,357,920
Unconditional Promises to Give, Net	10,103,523	8,121,291	3,081,097
Contributions receivable from split-interest agreements		2,621,559	
Accounts receivable	131,040		
Funds held in trust	1,055,479		
Accrued income receivable	10,662		68,622
Prepaid expenses			305,418
Miscellaneous receivables			176,877
Total Current Assets	20,006,442	170,535,883	115,776,804
Property and Equipment:			
Building			555,729
Furniture and Equipment	595,729		330,166
Leasehold Interest - Building	3,750,483		
Vehicle	26,422		
	4,372,634		885,895
Less: Allowance for Depreciation	(611,581)		(344,500)
Total Property and Equipment	3,761,053		541,395
Other Assets:			
Investments	109,245,007		63,511,749
Unconditional Promises to Give, Net	9,153,573		7,384,845
Restricted Cash	4,030,929		2,828,681
Split-Interest Agreements	1,409,000		3,332,190
Restricted Investments			373,343
Cash Surrender Value of Life Insurance		1,999,269	250,885
Total Other Assets	123,838,509	1,999,269	77,681,693
Total Assets	\$ 147,606,004	\$ 172,535,152	\$ 193,999,892
LIABILITIES			
Current Liabilities:			
Accounts Payable	\$ 18,445	\$ 95,123	\$ 335,745
Annuities Payable			
Accrued Expenses	182,800		224,198
Total Current Liabilities	201,245	95,123	559,943
Long-Term Debt	1,400,000		
Total Liabilities	1,601,245	95,123	559,943
NET ASSETS			
Unrestricted	14,735,793		8,597,748
Temporarily Restricted	54,416,312	70,058,589	113,391,928
Permanently Restricted	76,852,654	102,381,440	71,450,273
Total Net Assets	\$ 146,004,759	\$ 172,440,029	\$ 193,439,949
Total Liabilities and Net Assets	\$ 147,606,004	\$ 172,535,152	\$ 193,999,892

The accompanying notes to the financial statements are an integral part of this statement.

The University of North Carolina at Chapel Hill
Statement of Activities
For the Fiscal Year Ended June 30, 2009

Exhibit B-2

	UNC-CH Arts and Sciences Foundation, Inc.	The Educational Foundation Scholarship Endowment Trust	The Medical Foundation of North Carolina, Inc.
CHANGES IN UNRESTRICTED NET ASSETS			
Support:			
Contributions	\$ 7,109,864	\$ 4,194,595	19,582,061
Development Assessment Fee Income	2,316,635		
Change in Value of Split-Interest Agreements	(1,024,558)		(2,291,574)
Donated Facilities	82,675		
Actuarial Adjustment of Annuities Payable		22,036	
Endowment Investment Return Designated for Current Operations		7,567,992	
Total Support	<u>8,484,616</u>	<u>11,784,623</u>	<u>17,290,487</u>
Revenue:			
Interest and Dividend Income			4,434,813
Net Unrealized and Realized Losses on Investments	(28,598,291)		(38,333,789)
Investment Income	1,580,589		
Other Income	78,144		936,034
Total Revenues	<u>(26,939,558)</u>		<u>(32,962,942)</u>
Total Support and Revenue	<u>(18,454,942)</u>	<u>11,784,623</u>	<u>(15,672,455)</u>
EXPENSES			
Program Services:			
Grants	10,145,714		20,435,129
Scholarship Expense Distribution		7,556,100	
Annuity Payments		11,892	
Other Expenses		558,387	
Total Program Services	<u>10,145,714</u>	<u>8,126,379</u>	<u>20,435,129</u>
Supporting Services:			
Fundraising Expenses	2,569,495		1,175,686
Management and General	1,325,236		1,048,884
Total Supporting Services	<u>3,894,731</u>		<u>2,224,570</u>
Total Expenses	<u>14,040,445</u>	<u>8,126,379</u>	<u>22,659,699</u>
Loss from bad debt	1,477,608		2,728,982
Total Expenses and Bad Debt	<u>15,518,053</u>	<u>8,126,379</u>	<u>25,388,681</u>
Changes in Net Assets from Operations	<u>(33,972,995)</u>	<u>3,658,244</u>	<u>(41,061,136)</u>
OTHER CHANGES:			
Investment Return in Excess of Amounts Designated for Current Operations		(44,607,148)	
Changes in Net Assets	<u>(33,972,995)</u>	<u>(40,948,904)</u>	<u>(41,061,136)</u>
NET ASSETS			
Net Assets at Beginning of Year	<u>179,977,754</u>	<u>213,388,933</u>	<u>234,501,085</u>
Net Assets at End of Year	<u>\$ 146,004,759</u>	<u>\$ 172,440,029</u>	<u>\$ 193,439,949</u>

The accompanying notes to the financial statements are an integral part of this statement.

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

- A. Financial Reporting Entity** - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America (GAAP), the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The University of North Carolina at Chapel Hill (University) is a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

The accompanying financial statements present all funds belonging to the University and its component units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have delegated responsibilities for financial accountability of the University's funds. The University's component units are either blended or discretely presented in the University's financial statements. The blended component units, although legally separate, are, in substance, part of the University's operations and therefore, are reported as if they were part of the University. Discretely presented component units' financial data are reported in separate financial statements because of their use of different GAAP reporting models and to emphasize their legal separateness.

Blended Component Units - Although legally separate, The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. (Investment Fund), UNC Investment Fund, LLC (System Fund), UNC Management Company, Inc. (Management Company), The University of North Carolina at Chapel Hill Foundation, Inc. (UNC-Chapel Hill Foundation), The Kenan-Flagler Business School Foundation (Business School Foundation), UNC Law Foundation, Inc. (Law Foundation), and The University of North Carolina at Chapel Hill School of Education Foundation, Inc. (School of Education Foundation), are reported as if they were part of the University.

The Investment Fund is governed by a board consisting of 11 ex-officio directors and four elected directors. Ex-officio directors include all of the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

members of the Board of Trustees of the Endowment Fund of the University, which includes the Chairman of the University Board of Trustees and the Chancellor, the Vice Chancellor for Finance and Administration, and the Vice Chancellor for University Advancement. The UNC-Chapel Hill Foundation Board may, in its discretion, elect one or two of its at-large members to the Investment Fund Board. The Investment Fund supports the University by operating an investment fund for charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. Because members of the Board of Directors of the Investment Fund are officials or appointed by officials of the University and the Investment Fund's primary purpose is to benefit the University and other organizations operated primarily to support the University, its financial statements have been blended with those of the University.

The System Fund was organized by the Investment Fund to allow the University, other constituent institutions of the University of North Carolina System (UNC System), affiliated foundations, associations, trusts, and endowments that support the University and the UNC System, to pool their resources and invest collectively in investment opportunities identified, structured, and managed by the Management Company. The membership interests are offered only to government entities or tax-exempt organizations that are controlled by or support the University or UNC System. The Investment Fund contributed and assigned all of its assets to the System Fund effective January 1, 2003, in exchange for its membership interest in the System Fund. Upon such contribution and assignment, and in consideration thereof, the System Fund has assumed all liabilities and obligations of the Investment Fund in respect of such contributed assets. At June 30, 2009, the Investment Fund membership interest was approximately 79.1% of the System Fund total membership interests. Because the Investment Fund is the organizer and controlling member of the System Fund, the financial statements of the System Fund have been blended with those of the University.

The Management Company is a North Carolina nonprofit corporation organized and operated exclusively to support the educational mission of the University. The Management Company provides investment management and administrative services to the University, UNC System, and institutions and affiliated tax-exempt organizations, and performs other functions for and generally carries out the purposes of the University. The Management Company is governed by five ex-officio directors and one to three additional directors as fixed or changed from time to time by the board, elected by the ex-officio directors. The ex-officio directors consist of the Chancellor, the Vice Chancellor for Finance and Administration, the Chairman of the University Board of

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Trustees, the Chairman of the Board of Directors of the Investment Fund, and the President of the Management Company. Because members of the Board of Directors of the Management Company are officials or appointed by officials of the University and the Management Company's primary purpose is to benefit the University and other organizations operated primarily to support the University, its financial statements have been blended with those of the University.

The UNC-Chapel Hill Foundation is governed by a 17-member board consisting of nine ex-officio directors and eight elected directors. Ex-officio directors include the Chairman of the University Board of Trustees, the Chancellor, the Vice Chancellor for Finance and Administration, and the Vice Chancellor for University Advancement (non-voting). In addition, the Board of Trustees elects two ex-officio directors from among its own members as well as three ex-officio directors from the Board of Trustees of the Endowment Fund who have not otherwise been selected. The eight remaining directors are elected as members of the UNC-Chapel Hill Foundation Board of Directors by action of the ex-officio directors. The UNC-Chapel Hill Foundation aids, supports, and promotes teaching, research, and service in the various educational, scientific, scholarly, professional, artistic, and creative endeavors of the University. Because members of the Board of Directors of the UNC-Chapel Hill Foundation are officials or appointed by officials of the University and the UNC-Chapel Hill Foundation's sole purpose is to benefit the University, its financial statements have been blended with those of the University.

The Business School Foundation is governed by a board consisting of four ex-officio directors and four or more elected directors. Ex-officio directors include the dean of the Kenan-Flagler Business School (Business School), as well as the school's Chief Financial Officer, Associate Dean of Academic Affairs, and Associate Dean for MBA Programs. The remaining directors are elected to the Business School Foundation Board of Directors by action of the ex-officio directors. The Business School Foundation aids, promotes, and supports the Kenan-Flagler Business School at the University. Because members of the Board of Directors of the Business School Foundation are officials or appointed by officials of the University, the financial statements of the Business School Foundation have been blended with those of the University.

The Law Foundation is governed by a board consisting of one ex-officio director, six appointed directors, and six elected directors. The ex-officio director is the Dean of the School of Law of the University. The ex-officio director appoints six directors and the Board of Directors of the Law Alumni Association of the UNC, Inc. elects the other six directors.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Law Foundation provides support, fosters, and encourages the study and teaching of law at the University's Law School. Because a majority of the members of the Board of Directors of the Law Foundation are officials or appointed by officials of the University, the financial statements of the Law Foundation have been blended with those of the University.

The School of Education Foundation is governed by a board consisting of seven ex-officio directors and five elected directors. Ex-officio directors include the Dean of the School of Education, as well as the school's Associate Dean for Academic Programs, Assistant Dean for External Relations, Assistant Dean for Administration and Finance, Director of Alumni Relations, President of the Alumni Council, and President-Elect of the Alumni Council. The remaining directors are elected to the School of Education Foundation Board of Directors by action of the ex-officio directors. The School of Education Foundation aids, supports and promotes teaching, research, and service at the School of Education. Because members of the Board of Directors of the School of Education Foundation are officials or appointed by officials of the University, the financial statements of the School of Education Foundation have been blended with those of the University.

Separate financial statements for the Investment Fund, System Fund, the Management Company, and blended foundations may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

Discretely Presented Component Units - The Medical Foundation of North Carolina, Inc. (Medical Foundation), The Educational Foundation Scholarship Endowment Trust (Educational Foundation Trust), and The University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc. (Arts and Sciences Foundation) are legally separate, not for profit, tax-exempt organizations and are reported as discretely presented component units based on the nature and significance of their relationship to the University.

The Medical Foundation is governed by a board consisting of three ex-officio directors and 27 elected directors, which serve staggered terms. Its purpose is to support educational and research efforts of the University's Medical School and UNC Hospitals. Historically, the University's Medical School has been the major recipient of financial support from the Medical Foundation rather than UNC Hospitals. Although the University does not control the timing or amount of receipts from the Medical Foundation, the majority of resources or income that the Medical Foundation holds and invests is restricted to the University by the donors. Because these restricted resources held by the Medical

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Foundation can only be used by, or for the benefit of the University, the Medical Foundation is considered a component unit of the University.

The Arts and Sciences Foundation is governed by a board consisting of four ex-officio directors, 30 elected directors and such number of emeritus directors determined from time to time by the Board of Directors. The 30 elected directors are elected for staggered terms by the board of directors in office at the time of election. The purpose of the Arts and Sciences Foundation is to promote and support the University's College of Arts and Sciences. Although the University does not control the timing or amount of receipts from the Arts and Sciences Foundation, the majority of resources or income that the Arts and Sciences Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Arts and Sciences Foundation can only be used by, or for the benefit of the University, the Arts and Sciences Foundation is considered a component unit of the University.

The Educational Foundation Trust is governed by The Educational Foundation Scholarship Endowment Trust Agreement which designates the voting members of the Investment Committee of The Educational Foundation, Inc. as trustees. The Investment Committee consists of five members elected from the membership of the Educational Foundation, Inc. The Educational Foundation Trust operates solely to assist the University in providing financial assistance to students at the University. On an annual basis, the Board of Trustees of the Educational Foundation Trust appropriates a portion of the net appreciation on its assets to the Educational Foundation, Inc. in its capacity as agent for the Educational Foundation Trust. The distribution from the Educational Foundation Trust to the Educational Foundation, Inc. is then forwarded by the Educational Foundation, Inc. to the University to provide financial assistance to students at the University. Although the University does not control the timing or amount of receipts from the Educational Foundation Trust, the majority of resources or income that the Educational Foundation Trust holds and invests are restricted to the students of the University by the donors. Because these restricted resources held by the Educational Foundation Trust can only be used for the benefit of the students of the University, the Educational Foundation Trust is considered a component unit of the University.

The Medical Foundation, the Arts and Sciences Foundation, and the Educational Foundation Trust are private, nonprofit organizations that report their financial results under Financial Accounting Standards Board (FASB) Statements. As such, certain revenue recognition criteria and presentation features are different from Governmental Accounting Standards Board (GASB) revenue recognition criteria and presentation

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

features. No modifications have been made to the financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2009, the Medical Foundation, Arts and Sciences Foundation, and the Educational Foundation Trust distributed in total \$38,136,943 to the University for both restricted and unrestricted purposes. Complete financial statements for the Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust can be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

- B. Basis of Presentation** - The accompanying financial statements are presented in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

Pursuant to the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, as amended by GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, the full scope of the University's activities is considered to be a single business-type activity and accordingly, is reported within a single column in the basic financial statements.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the University does not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

- C. Basis of Accounting** - The financial statements of the University have been prepared using the economic resource measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred, regardless of the timing of the cash flows.

Nonexchange transactions, in which the University receives (or gives) value without directly giving (or receiving) equal value in exchange includes State appropriations, certain grants, and donations. Revenues are recognized, net of estimated uncollectible amounts, as soon as all

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

eligibility requirements imposed by the provider have been met, if probable of collection.

D. Cash and Cash Equivalents - This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the short-term investment fund. The short-term investment fund maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

E. Investments - Investments generally are reported at fair value. The fair values of all debt and equity securities with readily determinable fair market values are based on quoted market prices. Investments for which a readily determinable fair value does not exist include investments in certain commingled funds and limited partnerships. These investments are carried at estimated fair values as provided by the respective fund managers of these investments. The Management Company reviews and evaluates the values provided by the fund managers as well as the valuation methods and assumptions used in determining the fair value of such investments. Those estimated fair values may differ significantly from the values that would have been used had a ready market for these investments existed. The net increase or decrease in the fair value of investments is recognized as a component of investment income.

Money market funds, real estate not held by a governmental external investment pool, and other asset holdings are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated.

Short-term investments include marketable securities representing the investment of cash that is available for current operations. A majority of this available cash is invested in the University's Temporary Pool, a governmental external investment pool.

Endowment investments include the principal amount of gifts and bequests that, according to donor restrictions, must be held in perpetuity, along with any accumulated investment earnings on such amounts. Further, endowment investments also include amounts internally designated by the University for investment in an endowment capacity (i.e. quasi-endowments), along with accumulated investment earnings on such amounts. Land and other real estate held as investments by endowments are reported at fair value, consistent with how investments are generally reported.

F. Receivables - Receivables consist of tuition and fees charged to students and charges to patients for services provided by the UNC Physicians &

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Associates and the Dental Faculty Practices. Receivables also include amounts due from the federal government, state and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied, and notes receivables from loans to students. Patients, pledges, and notes receivables are recorded net of the allowance for doubtful accounts. The accounts and other receivables are shown at book value with no provision for doubtful accounts considered necessary.

G. Inventories - Inventories held by the University are priced at cost or average cost except for the Student Stores inventory, which is valued at the lower of cost or market. Inventories consist of expendable supplies, postage, fuel held for consumption, textbooks, and other merchandise for resale.

H. Capital Assets - Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

The University capitalizes assets that have a value or cost in excess of \$5,000 at the date of acquisition and an expected useful life of more than one year. Library books are generally not considered to have a useful life of more than one year unless part of a collection and are expensed in the year of acquisition.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 50 years for general infrastructure, 12 to 75 years for buildings, and six to 15 years for equipment.

The University's historic property, artworks, and literary collections are capitalized at cost or fair value at the date of donation. These properties and collections are considered inexhaustible and are therefore not depreciated.

I. Restricted Assets - Certain resources are reported as restricted assets because restrictions on asset use change the nature or normal understanding of the availability of the asset. Resources that are not available for current operations and are reported as restricted include resources restricted or designated for the acquisition or construction of capital assets and resources legally segregated for the payment of principal and interest as required by debt covenants.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- J. Funds Held in Trust for Pool Participants** - Funds held in trust for pool participants represent the external portion of the University's governmental external investment pool more fully described in Note 2. The assets associated with this liability are included in restricted investments for external pool participants, cash, and other similar asset accounts.
- K. Funds Held in Trust by Others** - Funds held in trust by others are resources neither in the possession nor the control of the University, but held and administered by an outside organization, with the University deriving income from such funds. Such funds established under irrevocable trusts where the University has legally enforceable rights or claims have not been recorded on the accompanying financial statements. The value of these assets at June 30, 2009 is approximately \$22,238,815.
- L. Noncurrent Long-term Liabilities** - Noncurrent long-term liabilities include principal amounts of bonds payable, notes payable, capital lease obligations, annuity and life income payable, and compensated absences that are not scheduled to be paid within the next fiscal year.

Bonds payable are reported net of unamortized premiums or discounts and deferred losses on refunds. The University amortizes bond premiums/discounts over the life of the bonds using the straight-line method. The deferred losses on refunds are amortized over the life of the old debt or new debt (whichever is shorter) using the straight-line method. Issuance costs are expensed.

- M. Compensated Absences** - The University's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30 equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30.

In addition to the vacation leave described above, compensated absences include the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly. The bonus leave balance on December 31 is retained by employees and transferred into the next calendar year. It is not subject to the limitation on annual leave carried forward described above and is not subject to conversion to sick leave.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out (LIFO) method.

There is no liability for unpaid accumulated sick leave because the University has no obligation to pay sick leave upon termination or retirement. However, additional service credit for retirement pension benefits is given for accumulated sick leave upon retirement.

N. Net Assets - The University's net assets are classified as follows:

Invested in Capital Assets, Net of Related Debt - This represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Restricted Net Assets – Nonexpendable - Nonexpendable restricted net assets include endowments and similar type assets whose use is limited by donors or other outside sources, and, as a condition of the gift, the principal is to be maintained in perpetuity.

Restricted Net Assets – Expendable - Expendable restricted net assets include resources for which the University is legally or contractually obligated to spend in accordance with restrictions imposed by external parties.

Unrestricted Net Assets - Unrestricted net assets include resources derived from student tuition and fees, sales and services, unrestricted gifts, royalties, and interest income.

Restricted and unrestricted resources are tracked using a fund accounting system and are spent in accordance with established fund authorities. Fund authorities provide rules for the fund activity and are separately established for restricted and unrestricted activities. When both restricted and unrestricted funds are available for expenditure, the decision for funding is transactional based within the departmental management system in place at the University. For projects funded by tax-exempt debt proceeds and other sources, the debt proceeds are always used first.

O. Scholarship Discounts - Student tuition and fees revenues and certain other revenues from University charges are reported net of scholarship discounts in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. The scholarship discount is the difference between the actual charge for goods and services provided by the University and the amount that is paid by students or by third parties on the students' behalf. Student financial assistance grants, such as Pell

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

grants, and other federal, state, or nongovernmental programs, are recorded as either operating or nonoperating revenues in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. To the extent that revenues from these programs are used to satisfy tuition, fees, and other charges, the University has recorded a scholarship discount.

- P. Revenue and Expense Recognition** - The University classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the University's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as (1) student tuition and fees, (2) sales and services of auxiliary enterprises, (3) certain federal, State and local grants and contracts that are essentially contracts for services, and (4) interest earned on loans. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions. Revenues from nonexchange transactions and State appropriations that represent subsidies or gifts to the University, as well as investment income, are considered nonoperating since these are investing, capital or noncapital financing activities. Capital contributions are presented separately after nonoperating revenues and expenses.

- Q. Internal Sales Activities** - Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such as utility services, telecommunications, central stores, printing and copy centers, postal services, repairs, and maintenance services. In addition, the University has other miscellaneous sales and service units that operated either on a reimbursement or charge basis. All internal sales activities to University departments from auxiliary operations and sales and service units have been eliminated in the accompanying financial statements. These eliminations are recorded by removing the revenue and expense in the auxiliary operations and sales and service units and, if significant, allocating any residual balances to those departments receiving the goods and services during the year.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 2 - DEPOSITS AND INVESTMENTS

- A. **Deposits** - Unless specifically exempt, the University is required by *North Carolina General Statute* 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. In addition, the University of North Carolina Board of Governors, pursuant to G.S. 116-36.1, requires the University to deposit its institutional trust funds, except for funds received for services rendered by health care professionals, with the State Treasurer. Although specifically exempted, the University may voluntarily deposit endowment funds, special funds, revenue bond proceeds, debt service funds, and funds received for services rendered by health care professionals with the State Treasurer. Special funds consist of moneys for intercollegiate athletics and agency funds held directly by the University.

At June 30, 2009, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$664,095,473, which represents the University's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a fund within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.8 years as of June 30, 2009. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Proceed directly to OSC's index page," then "Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

Cash on hand at June 30, 2009 was \$146,822. The carrying amount of the University's deposits not with the State Treasurer was \$197,095,566 and the bank balance was \$148,610,989. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. Pursuant to G.S. 116-36.1, funds received for health care services not deposited with the State Treasurer shall be fully secured in the manner as prescribed by the State Treasurer for the security of public deposits. The University does not have a deposit policy for custodial credit risk. As of June 30, 2009, \$145,701,143 of the University's bank balance was exposed to custodial credit risk as uninsured and uncollateralized.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

B. Investments - The University is authorized by The University of North Carolina Board of Governors pursuant to G.S. 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina, to invest its special funds and funds received for services rendered by health care professionals in the same manner as the State Treasurer is required to invest, as discussed below.

G.S. 147-69.1(c), applicable to the State's General Fund, and G.S. 147-69.2, applicable to institutional trust funds, authorize the State Treasurer to invest in the following: obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North Carolina; time deposits of specified institutions; prime quality commercial paper; and asset-backed securities with specified ratings. Also, G.S. 147-69.1(c) authorizes the following: specified bills of exchange or time drafts and corporate bonds and notes with specified ratings. G.S. 147-69.2 authorizes the following: general obligations of other states; general obligations of North Carolina local governments; and obligations of certain entities with specified ratings.

In accordance with the bond resolutions, bond proceeds and debt service funds are invested in obligations that will by their terms mature on or before the date funds are expected to be required for expenditure or withdrawal.

G.S. 116-36(e) provides that the trustees of the Endowment Fund shall be responsible for the prudent investment of the fund in the exercise of their sound discretion, without regard to any statute or rule of law relating to the investment of funds by fiduciaries but in compliance with any lawful condition placed by the donor upon that part of the Endowment Fund to be invested.

Investments of the University's component units, UNC-Chapel Hill Foundation, UNC Management Company Inc., Investment Fund, System Fund, Business School Foundation, Law Foundation, School of Education Foundation, Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust, are subject to and restricted by G.S. 36E "Uniform Prudent Management of Institutional Funds Act" (UPMIFA) and any requirements placed on them by contract or donor agreements.

Investments of various funds may be pooled unless prohibited by statute or by terms of the gift or contract. The University utilizes investment pools to manage investments and distribute investment income.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Investments are subject to the following risks.

Interest Rate Risk: Interest rate risk is the risk the University may face should interest rate variances affect the fair value of investments. The University does not have a formal policy that addresses interest rate risk.

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The University does not have a formal policy that addresses credit risk.

Foreign Currency Risk: Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The University does not have a formal policy for foreign currency risk.

Temporary Investment Pool (Temporary Pool) - This is a fixed income portfolio managed by the UNC Management Company, Inc. (Management Company) and Novant Asset Management, LLC. It operates in conjunction with the University's Bank of America disbursing account for all special funds, funds received for services rendered by health care professionals, and endowment revenue funds (internal portion) and funds of affiliated foundations (external portion). Because of the participation in the Temporary Pool by affiliated foundations, it is considered a governmental external investment pool. The external portion of the Temporary Pool is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. Fund ownership of the University's Temporary Pool is measured using the unit value method. Under this method, each participant's investment balance is determined on a market value basis. The Temporary Pool is not registered with the SEC and is not subject to any formal oversight other than that provided by the University Board of Trustees. The University has not provided legally binding guarantees during the period to support the value of the pool's investments. There are no involuntary participants in the Temporary Pool.

The Northern Trust Company (TNT) was the custodian for the Temporary Pool for the first half of the fiscal year. Effective January 1, 2009, the Bank of New York Mellon replaced TNT and provides the University with monthly statements defining income and market value information. Investments of the Temporary Pool are highly liquid and generally include U.S. government securities, collateralized mortgage obligations, corporate bonds, and mutual funds. The University has elected to invest a portion of the Temporary Pool assets in the University's Investment Fund.

By request to accounting services, participants may purchase and sell shares in the Temporary Pool at a fixed value of \$1 per share. Generally, the purchase and sale of participation shares occur only at the beginning

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

of the month. Income distribution is determined each quarter by multiplying the distribution rate by the average of the invested fund balance. Statements are provided via internet website to each participating account or group of accounts on a quarterly basis reflecting the participants' balance and income distribution. The rate earned by an account is dependent upon its account classification and investable fund balance. The rates are set in coordination between the Management Company and the Vice Chancellor for Finance and Administration.

The following table presents the fair value of the Temporary Pool investments by type and investments subject to interest rate risk at June 30, 2009.

Temporary Pool Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
<i>Debt Securities</i>					
U.S. Treasuries	\$ 39,390,934	\$ 0	\$ 39,390,934	\$ 0	\$ 0
U.S. Agencies	146,489,855	12,312,074	56,515,636	11,180,995	66,481,150
Collateralized Mortgage Obligations	49,862,939			421,518	49,441,421
Asset-Backed Securities	4,783,196				4,783,196
Mutual Bond Funds	14,412,763		8,525,434	5,800,870	85,459
Domestic Corporate Bonds	2,260,655				2,260,655
Total Debt Securities	257,200,342	\$ 12,312,074	\$ 104,432,004	\$ 17,403,383	\$ 123,052,881
<i>Other Securities</i>					
Domestic Stocks	30,000				
Total Temporary Pool Investments	\$ 257,230,342				

At June 30, 2009, investments in the Temporary Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB/Ba and below	Unrated
U.S. Agencies	\$ 146,489,855	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 146,489,855
Collateralized Mortgage Obligations	49,862,939	11,731,648	2,969,430	12,013,974	5,268,922	13,567,960	4,311,005
Asset-backed Securities	4,783,196		2,471,550	436,441	153,085	1,722,120	
Mutual Bond Funds	14,412,763	9,162,079	1,532,514	3,718,170			
Domestic Corporate Bonds	2,260,655			267,438	500,000	1,493,217	
Total	\$ 217,809,408	\$ 20,893,727	\$ 6,973,494	\$ 16,436,023	\$ 5,922,007	\$ 16,783,297	\$ 150,800,860

Rating Agency: Moody's/Standard & Poor's/Fitch

Since a separate annual financial report of the Temporary Investment Pool has not been and is not planned to be issued, the following additional disclosures are being provided in the University's financial statements.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Temporary Investment Pool's Statement of Net Assets and Statement of Operations and Changes in Net Assets as of and for the period ended June 30, 2009, are as follows:

Statement of Net Assets

June 30, 2009

	Amount
<i>Assets:</i>	
Cash in Bank	\$ 80,841,437
State Treasurer Investment Fund	85,000,000
Accounts Receivable	33
Accrued Investment Income	2,253,923
Investment Fund	38,078,963
Investments	257,230,342
Total Assets	\$ 463,404,698
<i>Liabilities:</i>	
Deferred Income	\$ 863,836
Accounts Payable	5,052,495
Total Liabilities	5,916,331
<i>Net Assets:</i>	
Internal Portion	276,643,216
External Portion	180,845,151
Total Net Assets	457,488,367
Total Liabilities and Net Assets	\$ 463,404,698

Statement of Operations and Changes in Net Assets

For the Fiscal Year Ended June 30, 2009

	Amount
<i>Increase in Net Assets from Operations:</i>	
<i>Revenues:</i>	
Investment Income	\$ 18,166,197
<i>Expenses:</i>	
Investment Management	(769,900)
Net Increase in Net Assets Resulting from Operations	17,396,297
<i>Distributions to Participants:</i>	
Distributions Paid and Payable	(17,396,297)
<i>Share Transactions:</i>	
Net Share Purchases	58,840,399
Total Increase in Net Assets	58,840,399
<i>Net Assets:</i>	
Beginning of Year	398,647,968
End of Year	\$ 457,488,367

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Intermediate Investment Pool - Established in October 2007, this is a portfolio managed by the UNC Management Company, Inc. (Management Company) and is comprised of fixed income investments and investments with The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. Participation in the Intermediate Pool is open to all participants that are eligible for the UNC Chapel Hill Temporary Investment Pool, however currently the University is the only member. Fund ownership of the University's Intermediate Pool is measured using the unit value method. Under this method, each participant's investment balance is determined on a market value basis. The Intermediate Pool is not registered with the SEC and is not subject to any formal oversight other than that provided by the University Board of Trustees. The University has not provided legally binding guarantees during the period to support the value of the pool's investments. There are no involuntary participants in the Intermediate Pool.

The Northern Trust Company (TNT) was the custodian for the Intermediate Pool for the first half of the fiscal year. Effective January 1, 2009, the Bank of New York Mellon replaced TNT and provides the University with monthly statements defining income and market value information. Generally a minimum of 45% and a maximum of 65% of the market value of the Intermediate Pool will be invested in The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. The remaining assets of the Intermediate Pool will be invested primarily (at least 80%) in cash, money market instruments, high quality bonds, and other high quality fixed income instruments in accordance with the Investment Guidelines.

By written request to university accounting services, the purchase and sale of participation shares occur at the beginning of the month. As calculated by the Management Company, returns net of fees and expenses will be allocated 85% to the Intermediate Pool participants and 15% to the University. Statements are provided by the Management Company to each participant on a monthly basis reflecting the participants' balance and investment activity.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The following table presents the fair value of the fixed income segment of the Intermediate Pool investments by type and investments subject to interest rate risk at June 30, 2009.

Intermediate Pool Investments

Investment Type	Fair Value	Investment Maturities (in Years)			More than 10
		Less Than 1	1 to 5	6 to 10	
<i>Debt Securities</i>					
Mutual Bond Funds	\$ 6,771,203	\$ 0	\$ 0	\$ 6,771,203	\$ 0
Money Market Mutual Funds	6,665,683	6,665,683			
Total Intermediate Pool Investments	\$ 13,436,886	\$ 6,665,683	\$ 0	\$ 6,771,203	\$ 0

At June 30, 2009, investments in the Intermediate Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA	Unrated
Mutual Bond Funds	\$ 6,771,203	\$ 0	\$ 6,771,203	\$ 0
Money Market Mutual Funds	6,665,683	6,665,683		
Total	\$ 13,436,886	\$ 6,665,683	\$ 6,771,203	\$ 0

Rating Agency: Moody's/Standard & Poor's

At June 30, 2009, the Intermediate Investment Pool had investments of \$18,307,784 in the Investment Fund.

UNC-Chapel Hill Foundation Investment Fund, Inc. (Investment Fund) - This is a North Carolina nonprofit corporation exempt from income tax pursuant to Section 501(c)(3). It was established in January 1997 and is classified as a governmental external investment pool. The pool is utilized to manage the investments for charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. The University's Endowment, UNC-Chapel Hill Foundation, Business School Foundation, School of Education Foundation, Law Foundation, Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust are participants in the Investment Fund and are included in the University's reporting entity (internal portion). Other affiliated organizations (external portion) in the Investment Fund are not included in the University's reporting entity. Fund ownership of the University's Investment Fund is measured using the unit value method. Under this method, each participant's investment balance is determined on a market value basis. The external portion of the Investment Fund is presented in

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the accompanying financial statements as Funds Held in Trust for Pool Participants.

The Investment Fund is not registered with the SEC and is not subject to any formal oversight other than that provided by the Investment Fund Board of Directors (See Note 1A).

The Investment Fund is the primary participant of UNC Investment Fund, LLC (System Fund) and on a monthly basis receives a unitization report from the Management Company defining change in book and market value, applicable realized gains and losses and expenses. The Investment Fund uses a unit basis to determine each participant's market value and to distribute the fund's earnings according to the fund's spending policy. There are no involuntary participants in the Investment Fund. The University has not provided or obtained any legally binding guarantees during the period to support the value for the Investment Fund. The audited financial statements for the Investment Fund may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

The Investment Fund consists of an approximately 79.1% membership in the System Fund categorized below.

UNC Investment Fund, LLC (System Fund) - This is a limited liability company organized under the laws of the State of North Carolina. It was established in December 2002 by the Investment Fund and is classified as a governmental external investment pool. The pool is utilized to manage the investments for The University of North Carolina, its constituent institutions, and affiliates of the constituent institutions. This includes charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support these institutions. The Investment Fund, with an approximately 79.1% membership interest as of June 30, 2009, is the predominant member of the System Fund. The University's reporting entity portion of the Investment Fund is characterized as the internal portion. Other affiliated organizations in the Investment Fund in addition to other members of the System Fund not included in the University's reporting entity are characterized as the external portion. The external portion of the System Fund is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. Membership interests of the System Fund are measured using the unit value method. Under this method, each member's investment balance is determined on a market value basis.

The System Fund is not registered with the SEC and is not subject to any formal oversight other than that provided by the Investment Fund as the controlling member and the Management Company (See Note 1A).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Effective January 1, 2003, the Management Company entered into an investment management services agreement with the System Fund and will provide investment management and administrative services.

The Northern Trust Company (TNT) was the custodian for the System Fund for the first half of the fiscal year. Effective January 1, 2009, the Bank of New York Mellon replaced TNT and provides the University with monthly statements defining income and market value information. The System Fund uses a unit basis to determine each member's market value and to distribute the fund's earnings. There are no involuntary participants in the System Fund. The University has not provided or obtained any legally binding guarantees during the period to support the value for the System Fund investments. The audited financial statements for the System Fund may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

The following table presents the fair value of the System Fund investments by type and investments subject to interest rate risk at June 30, 2009.

System Fund Pool Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
<i>Debt Securities</i>					
U.S. Treasuries	\$ 70,567,005	\$ 8,693,534	\$ 36,928,486	\$ 0	\$ 24,944,985
U.S. Agencies	14,096,021			48,377	14,047,644
Collateralized Mortgage Obligations	2,721,354				2,721,354
Mutual Bond Funds	1,354,094			1,354,094	
Domestic Corporate Bonds	19,580,647		468,880	2,612,015	16,499,752
Foreign Government Bonds	10,285,682			10,285,682	
Total Debt Securities	118,604,803	\$ 8,693,534	\$ 37,397,366	\$ 14,300,168	\$ 58,213,735
<i>Other Securities</i>					
International Mutual Funds	155,154,658				
Other Mutual Funds	54,398,530				
Real Estate Investment Trust	166,540				
Hedge Funds	992,915,224				
Limited Partnerships	783,862,879				
Domestic Stocks	90,286,572				
Foreign Stocks	588,737				
Total System Fund Pool Investments	\$ 2,195,977,943				

The System Fund includes \$190 million in commingled securities and \$28 million in high-yield bonds. The commingled securities are subject to additional risk since they hold domestic corporate bonds, bonds issued from abroad, or mortgage-backed securities. Bonds issued from overseas carry additional risk due to currency fluctuations, interest rates of foreign

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

countries, or political risks. Corporate bonds are also subject to interest rate risk as well as the financial risk inherent in any company. Mortgage-backed bonds are subject to the interest rate risk within the pools of collateralized securities. All of these factors may impact interest rates and therefore have a higher risk. The high-yield bonds have both long and short positions. These strategies carry additional risk since high-yield securities often have a higher rate of default to accompany their higher interest rates. These factors make the investments more sensitive to interest rate movements than investment grade domestic bonds.

At June 30, 2009, investments in the System Fund Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB/Ba & Below	Unrated
U.S. Agencies	\$ 14,096,021	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 14,096,021
Collateralized Mortgage Obligations	2,721,354	957,390				1,763,964	
Mutual Bond Funds	1,354,094	1,354,094					
Domestic Corporate Bonds	19,580,647	653,860	2,519,685	9,070,015	7,337,087		
Foreign Government Bonds	10,285,682		10,285,682				
Total	\$ 48,037,798	\$ 2,965,344	\$ 12,805,367	\$ 9,070,015	\$ 7,337,087	\$ 1,763,964	\$ 14,096,021

Rating Agency: Moody's/Standard and Poor's/Fitch

Foreign Currency Risk: At June 30, 2009, the System Fund Pool's exposure to foreign currency risk is as follows:

	Currency	Fair Value (U.S. Dollars)
Limited Partnerships	Euro	\$ 52,516,467
Limited Partnerships	British Pound Sterling	4,996,110
Limited Partnerships	Australian Dollar	1,428,390
Limited Partnerships	Canadian Dollar	305,265
Foreign Stock	Canadian Dollar	175,051
Total		\$ 59,421,283

In addition to the foreign currency risk disclosed above, the System Fund invests in hedge funds containing securities with fair values that are highly sensitive to interest rate changes.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Non-Pooled Investments - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2009.

Non-Pooled Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
<i>Debt Securities</i>					
U.S. Treasuries	\$ 256,675	\$ 35,470	\$ 70,241	\$ 69,973	\$ 80,991
U.S. Agencies	318,564	39,775	223,226	55,563	
Mortgage Pass Throughs	227,714			129,479	98,235
Collateralized Mortgage Obligations	54,700				54,700
State and Local Government	94,937				94,937
Asset-Backed Securities	35,000				35,000
Mutual Bond Funds	5,556,900		275,990	4,501,811	779,099
Money Market Mutual Funds	46,162,103	46,162,103			
Domestic Corporate Bonds	293,759		23,054	270,705	
Foreign Corporate Bonds	108,865		24,865	27,174	56,826
Foreign Government Bonds	28,581				28,581
Total Debt Securities	53,137,798	\$ 46,237,348	\$ 617,376	\$ 5,054,705	\$ 1,228,369
<i>Other Securities</i>					
International Mutual Funds	7,418,513				
Other Mutual Funds	6,832,662				
Investments in Real Estate	1,783,303				
Real Estate Investment Trust	135,898				
Limited Partnerships	2,302,309				
Domestic Stocks	12,062,147				
Foreign Stocks	208,195				
Other	17,753,776				
Total Non-Pooled Investments	\$ 101,634,601				

At June 30, 2009, the University's Non-Pooled investments had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB/Ba and below	Unrated
U.S. Agencies	\$ 318,564	\$ 164,273	\$ 0	\$ 0	\$ 0	\$ 0	\$ 154,291
Mortgage Pass Throughs	227,714	191,310		36,404			
Collateralized Mortgage Obligations	54,700	42,702		11,998			
State and Local Government	94,937			94,937			
Asset-backed Securities	35,000			35,000			
Mutual Bond Funds	5,556,900	198,548	4,410,514	309,520	240,480	397,838	
Money Market Mutual Funds	46,162,103	46,112,761		49,342			
Domestic Corporate Bonds	293,759		103,770	116,798		73,191	
Foreign Corporate Bonds	108,865		52,039			56,826	
Foreign Government Bonds	28,581			28,581			
Total	\$ 52,881,123	\$ 46,709,594	\$ 4,566,323	\$ 682,580	\$ 240,480	\$ 527,855	\$ 154,291

Rating Agency: Moody's/Standard & Poor's/Fitch

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Total Investments - The following table presents the fair value of the total investments at June 30, 2009.

Investment Type	Fair Value
<i>Debt Securities</i>	
U.S. Treasuries	\$ 110,214,614
U.S. Agencies	160,904,440
Mortgage Pass Throughs	227,714
Collateralized Mortgage Obligations	52,638,993
State and Local Government	94,937
Asset-Backed Securities	4,818,196
Mutual Bond Funds	28,094,960
Money Market Mutual Funds	52,827,786
Domestic Corporate Bonds	22,135,061
Foreign Corporate Bonds	108,865
Foreign Government Bonds	10,314,263
Total Debt Securities	442,379,829
<i>Other Securities</i>	
International Mutual Funds	162,573,171
Other Mutual Funds	61,231,192
Investments in Real Estate	1,783,303
Real Estate Investment Trust	302,438
Hedge Funds	992,915,224
Limited Partnerships	786,165,188
Domestic Stocks	102,378,719
Foreign Stocks	796,932
Other	17,753,776
Total Investments	\$ 2,568,279,772

Total investments include \$307,019,389 held in the System Fund for the component units that are discretely presented in the accompanying financial statements. The University's reporting entity, including the three discretely presented component units, comprises 64.9% of the System Fund.

Component Units - Investments of the University's discretely presented component unit, the Medical Foundation of North Carolina, Inc., are subject to and restricted by G.S. 36E "Uniform Prudent Management of Institutional Funds Act" (UPMIFA) and any requirements placed on them by contract or donor agreements. Because the Medical Foundation reports under the FASB reporting model, disclosures of the various investment risks are not required. The following is an analysis of investments not held by the University:

Investment Type	Carrying Value
Certificates of Deposit	\$ 508,738
Mutual Funds	60,280,228
Private Equities	17,120,201
Total Investments	\$ 77,909,167

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 3 - ENDOWMENT INVESTMENTS

Substantially all of the investments of the University's endowment funds are pooled in the Investment Fund. Under the "Uniform Prudent Management of Institutional Funds Act" (UPMIFA), authorized by the North Carolina General Assembly on March 19, 2009, the Board may appropriate expenditures from eligible nonexpendable balances if deemed prudent and necessary to meet program outcomes and for which such spending is not specifically prohibited by the donor agreements. During the year, the Board did not appropriate expenditures from eligible nonexpendable endowment funds. Investment return of the University's pooled endowment funds is predicated on the total return concept (yield plus appreciation). Annual distributions from the Investment Fund to the University's pooled endowment funds are generally based on an adopted distribution policy. Under this policy, the prior year distribution is increased by the rate of inflation as measured by the Consumer Price Index (CPI). Each year's distribution, however, is subject to a minimum of 4% and a maximum of 7% of the pooled endowment fund's average market value for the previous year.

To the extent that the total return for the current year exceeds the distribution, the excess is added to principal. If current year earnings do not meet the distribution requirements, the University uses accumulated income and appreciation to make up the difference. At June 30, 2009, accumulated income and appreciation of \$396,370,072 was available in the University's pooled endowment funds of which \$357,031,088 was restricted to specific purposes.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 - RECEIVABLES

Receivables at June 30, 2009, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables			
Students	\$ 3,797,016	\$ 0	\$ 3,797,016
Patients	104,883,489	56,536,816	48,346,673
Accounts	61,992,013		61,992,013
Intergovernmental	39,231,484		39,231,484
Pledges	18,179,259	454,482	17,724,777
Investment Earnings	5,697,610		5,697,610
Interest on Loans	654,938		654,938
Other	29,215		29,215
Total Current Receivables	\$ 234,465,024	\$ 56,991,298	\$ 177,473,726
Noncurrent Receivables			
Pledges	\$ 30,906,331	\$ 772,658	\$ 30,133,673
Notes Receivable			
Notes Receivable - Current			
Federal Loan Programs	\$ 3,289,281	\$ 214,520	\$ 3,074,761
Institutional Student Loan Programs	775,940	57,600	718,340
Total Notes Receivable - Current	\$ 4,065,221	\$ 272,120	\$ 3,793,101
Notes Receivable - Noncurrent			
Federal Loan Programs	\$ 30,594,739	\$ 1,930,678	\$ 28,664,061
Institutional Student Loan Programs	5,520,268	145,078	5,375,190
Total Notes Receivable - Noncurrent	\$ 36,115,007	\$ 2,075,756	\$ 34,039,251

Pledges are receivable over varying time periods ranging from one to 10 years, and have been discounted based on a projected interest rate of 2.30% for the outstanding periods, and allowances are provided for the amounts estimated to be uncollectible.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Scheduled receipts, the discounted amount under these pledge commitments, and allowances for uncollectible pledges are as follows:

Fiscal Year	Amount
2010	\$ 18,179,259
2011	12,414,867
2012	10,806,143
2013	7,107,977
2014	760,575
2015-2019	1,965,042
Total Pledge Receipts Expected	51,233,863
Less Discount Amount Representing Interest (2.30% Rate of Interest)	2,148,273
Present Value of Pledge Receipts Expected	49,085,590
Less Allowance for Uncollectible	1,227,140
Pledges Receivable	\$ 47,858,450

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2009, is presented as follows:

	Balance July 1, 2008	Increases	Decreases	Balance June 30, 2009
Capital Assets, Nondepreciable:				
Land	\$ 28,452,957	\$ 10,706,840	\$ 727,859	\$ 38,431,938
Art, Literature, and Artifacts	70,094,973	4,074,700	6,322	74,163,351
Construction in Progress	665,936,094	160,927,191	212,554,807	614,308,478
Intangible	16,607,286	17,224,877		33,832,163
Total Capital Assets, Nondepreciable	781,091,310	192,933,608	213,288,988	760,735,930
Capital Assets, Depreciable:				
Buildings	1,729,423,725	287,785,128	2,610,267	2,014,598,586
Machinery and Equipment	266,026,906	44,708,710	15,089,561	295,646,055
General Infrastructure	416,156,039	6,117,085		422,273,124
Total Capital Assets, Depreciable	2,411,606,670	338,610,923	17,699,828	2,732,517,765
Less Accumulated Depreciation/Amortization for:				
Buildings	545,159,352	45,714,255	1,731,025	589,142,582
Machinery and Equipment	154,881,007	13,572,913	10,396,122	158,057,798
General Infrastructure	203,642,168	11,459,942		215,102,110
Total Accumulated Depreciation	903,682,527	70,747,110	12,127,147	962,302,490
Total Capital Assets, Depreciable, Net	1,507,924,143	267,863,813	5,572,681	1,770,215,275
Capital Assets, Net	\$ 2,289,015,453	\$ 460,797,421	\$ 218,861,669	\$ 2,530,951,205

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2009, were as follows:

	Amount
Accounts Payable	\$ 69,158,469
Accrued Payroll	41,023,552
Contract Retainage	6,078,108
Intergovernmental and Other Payables	103,393
Total Accounts Payable and Accrued Liabilities	\$ 116,363,522

NOTE 7 - SHORT-TERM DEBT

Short-term debt activity for the year ended June 30, 2009, was as follows:

	Balance July 1, 2008	Draws	Repayments	Balance June 30, 2009
Commercial Paper Program	\$ 101,157,000	\$ 68,000,000	\$ (20,866,000)	\$ 148,291,000
Line of Credit		1,702,507	(1,702,507)	
Total Short-Term Debt	\$ 101,157,000	\$ 69,702,507	\$ (22,568,507)	\$ 148,291,000

The University's commercial paper program provides up to \$400,000,000 in short-term financing for the University's capital improvement projects and is supported by a pledge of the University's available funds. The University will typically utilize the commercial paper program for construction financing and will periodically issue long-term bonds to refund the outstanding balances under this program in order to provide permanent financing for these capital improvement projects.

Commercial paper was redeemed with proceeds from The University of North Carolina General Revenue Bonds, Series 2007 and payments from campus entities with outstanding commercial paper.

Due to disruptions associated with the bankruptcy filing by Lehman Brothers, Lehman failed to remarket \$1,702,507 in 2001B variable rate demand bonds on September 22, 2008, so the University drew on the Wachovia Line of Credit in the amount of \$1,702,507 to facilitate the purchase of the bonds until they could be remarketed. When JP Morgan Chase became the remarketing agent for the 2001B bonds on September 29, 2008, the bonds purchased with the Wachovia Line of Credit were successfully remarketed, and the Wachovia Line of Credit was paid in full. Since that one-time draw under the Wachovia Line of Credit, there have been no subsequent failed remarketings associated with the 2001 B&C bonds and the Commercial Paper Program.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 8 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2009, is presented as follows:

	Balance July 1, 2008	Additions	Reductions	Balance June 30, 2009	Current Portion
Bonds Payable	\$ 1,080,835,000	\$	\$ 24,055,000	\$ 1,056,780,000	\$ 97,675,014
Add/Deduct Premium/Discount	(6,509,702)		(3,200,598)	(3,309,104)	
Deduct Deferred Charge on Refunding	(3,436,415)		(401,922)	(3,034,493)	
Total Bonds Payable	1,070,888,883		20,452,480	1,050,436,403	97,675,014
Notes Payable	1,037,000		362,000	675,000	675,000
Arbitrage Rebate Payable	42,213		42,213		
Capital Leases Payable	2,804,533	84,205	1,178,596	1,710,142	737,464
Compensated Absences	117,154,685	68,725,878	60,538,448	125,342,115	7,056,048
Annuity and Life Income Payable	10,302,515	2,506,041	1,253,540	11,555,016	1,378,618
Total Long-Term Liabilities	\$ 1,202,229,829	\$ 71,316,124	\$ 83,827,277	\$ 1,189,718,676	\$ 107,522,144

Additional information regarding capital lease obligations is included in Note 9.

B. Bonds Payable - The University was indebted for bonds payable for the purposes shown in the following table:

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Amount of Issue plus Capital Appreciation	Principal Paid Through June 30, 2009	Discount on Capital Appreciation Bonds	Outstanding plus Capital Appreciation June 30, 2009
General Revenue	2001A	5.25% - 5.375%	12/01/25	\$ 89,930,000	\$ 51,090,000	\$ 0	\$ 38,840,000
	2001B	Variable	12/01/25	54,970,000	15,455,000		39,515,000
	2001C	Variable	12/01/25	54,970,000	15,455,000		39,515,000
	2002B	5.00%	12/01/11	66,555,000	41,500,000		25,055,000
	2003	3.00% - 4.63%	12/01/33	107,960,000	9,065,000		98,895,000
	2005	3.50% - 5.00%	12/01/34	404,960,000	1,670,000		403,290,000
	2007	4.45 - 5.00%	12/01/36	298,475,000			298,475,000
	Total General Revenue			1,077,820,000	134,235,000		943,585,000
Housing System	1997B	4.80% - 5.00%	11/01/11	7,210,000	4,725,000		2,485,000
Parking System	1997B	5.15%	05/15/09	8,245,000	8,245,000		
Utilities System	1997	5.25% - 5.50%	08/01/21	84,135,000		(27,470,806)	56,664,194
Student Union	2000	5.00%	06/01/10	12,465,000	11,965,000		500,000
Student Recreation Center	1997	4.70% - 5.00%	06/01/11	3,545,000	2,745,000		800,000
U.S. EPA Project	1991	9.05%	02/15/15	58,125,000	32,850,000	(5,989,243)	19,285,757
Total Bonds Payable (principal only)				\$ 1,251,545,000	\$ 194,765,000	\$ (33,460,049)	1,023,319,951
Less: Unamortized Loss on Refunding							(3,034,493)
Plus: Unamortized Discount							30,150,945
Total Bonds Payable							\$ 1,050,436,403

General Revenue bonds were issued for various construction projects and refund of bonds and commercial paper.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The University has pledged future revenues, net of specific operating expenses, to repay revenue bonds as shown in the table below:

Ref	Revenue Source	Total Future Revenues Pledged	Current Year Revenues Net of Expenses	Current Year Principal, Interest & Accretion	Estimate of % of Revenues Pledged
(1)	Housing Revenues	\$ 2,673,543	\$ 12,191,965	\$ 879,039	7%
(2)	Parking Revenues		3,694,405	961,665	0%
(3)	Student Fees	1,385,500	1,704,657	898,440	27%
(4)	Utilities	84,135,000	29,030,417	2,947,590	22%

C. Demand Bonds - Included in bonds payable are several variable rate demand bond issues. Demand bonds are securities that contain a “put” feature that allows bondholders to demand payment before the maturity of the debt upon proper notice to the University’s remarketing or paying agents.

With regards to the following demand bonds, the University has not entered into legal agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

General Revenue, Series 2001B and 2001C

In 2001 the University issued two series of variable rate demand bonds in the amount of \$54,970,000 (2001B) and \$54,970,000 (2001C) that each has a final maturity date of December 1, 2025. The bonds are subject to mandatory sinking fund redemption on the interest payment date on or immediately preceding each December throughout the term of the bonds. The proceeds of these issuances were used to provide funds to refund in advance of their maturity the following issues: Ambulatory Care Clinic, Series 1990; Athletic Facilities, Series 1998; Carolina Inn, Series 1994; School of Dentistry, Series 1995; Kenan Stadium, Series 1996; and Parking System, Series 1997C. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the University’s remarketing agents J.P. Morgan Chase (2001B) and Bank of America, LLC (2001C). Effective September 23, 2008, J.P. Morgan Chase replaced Lehman Brothers, Inc.

The University entered into a line of credit agreement in the amount of \$300,000,000 with Wachovia Bank (or Bank) on September 21, 2006. Under the line of credit agreement, the University is entitled to draw amounts sufficient to pay the principal and accrued interest on Variable Rate Demand Bonds (or Commercial Paper Bonds) delivered for purchase. Under the line of credit agreement, the University may request that the Bank increase the commitment by increments of \$25,000,000 for

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

a total commitment of up to \$400,000,000. A request for increase is subject to the Bank's sole discretion, and the University cannot be in default under the agreement at the time of the request. During fiscal year 2009, Wells Fargo purchased Wachovia Bank, but the line of credit agreement remains in place under original terms and conditions.

The University is required to pay a quarterly facility fee for the line of credit in the amount of 0.08% per annum based on the size of the commitment. If a long-term debt rating assigned by S&P, Moody's, or Fitch is lowered, the facility fee assigned to the lowest rating in the below table shall apply:

S&P	Fitch	Moody's	Facility Fee
AA	AA	Aa2	0.10%
AA-	AA-	Aa3	0.11%
A+	A+	A1	0.14%
A	A	A2	0.18%

In the event that the Bank increases the available commitment prior to the due date for payment of a facility fee, upon request by the University as referenced in the prior paragraph, the University must pay a supplemental fee based on the facility fee applied to the amount of the increase at the time of commitment to increase. The University will also pay an accrued interest fee equal to the amount of accrued interest, at the time of purchase of the bonds, multiplied by the prime rate multiplied by the ratio of the number of days from the date of purchase of the bonds until the date of payment of the accrued interest to 365 days.

Under the line of credit agreement, draws to purchase bonds will accrue interest at the prime rate payable on the same interest date as provided in the trust agreement for the original bonds. The University is required to begin making a series of 10 fully amortizing semi-annual principal payments on bonds held by the Bank six months after the date of purchase. Commercial paper bonds held by the Bank may be rolled over for a period of 180 days and must be reduced by 1/10th of the original amount of the commercial paper bonds for a period of up to 10 rollovers. All outstanding principal and accrued but unpaid interest is due in full at the maturity of the line of credit.

The line of credit agreement expires on September 21, 2011 and is subject to covenants customary to this type of transaction, including a default provision in the event that the University's long-term bond ratings were lowered to below a BBB- for S&P, BBB- for Fitch, and Baa3 for Moody's.

Interest Rate Swaps:

Lehman Brothers Special Financing, Inc.

In order to protect against the risk of interest rate changes, effective October 3, 2000, the University entered into an interest rate swap agreement with Lehman Brothers Special Financing, Inc. (Lehman Brothers) related to \$22,000,000 of The University of North Carolina at Chapel Hill Variable Rate Housing System Revenue Bonds, Series 2000. This series of bonds was refunded in its entirety by the issuance of the University's Variable Rate General Revenue Demand Bonds, Series 2001B (2001B Bonds), and the interest rate swap agreement was amended to reflect the refunding.

Under this amended agreement, Lehman Brothers pays the University interest on the notional amount based on the Securities Industry and Financial Markets Association (SIFMA) index on a quarterly basis. On a semiannual basis, the University pays Lehman Brothers interest at the fixed rate of 5.24%. The notional amount of the swap reduces annually in conjunction with the 2001B Bonds; the reductions began in November 2002 and end in November 2025. The swap agreement matures November 1, 2025. As of June 30, 2009, rates were as follows:

	<u>Terms</u>	<u>Rate</u>
Fixed Payment to Lehman	Fixed	5.24%
Variable Payment from Lehman	SIFMA	<u>0.32%</u>
Net Interest Rate Swap Payments		4.92%
Variable -Rate Bond Coupon Payments		<u>0.17%</u>
Synthetic Interest Rate on Bonds		<u><u>5.09%</u></u>

During fiscal year 2009, Lehman Brothers Special Financing, Inc., filed for bankruptcy and therefore no longer disburses the variable payment scheduled under the agreement to the University. To account for this consideration, as allowed under the swap documents, the University reduced its scheduled fix payment by netting against this payment the amount that should have been received from Lehman Brothers based upon SIFMA.

As of June 30, 2009, the swap had a fair value of negative \$3,679,966. The fair value was provided by the University's financial advisor, Prager, Sealy, & Co. Their method calculates the future net settlement payments required by the swap assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

payments are then discounted using the spot rates implied by the current yield curve for LIBOR (London Interbank Offered Rate) due on the date of each future net settlement on the swap.

As of June 30, 2009, the University was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap becomes positive, the University would be exposed to credit risk in the amount of the derivative's positive fair value. Should the swap have a positive fair value of more than \$1,000,000, at that point Lehman Brothers would be required to collateralize 103% of their exposure. Lehman Brothers Holdings, guarantor of Lehman Brothers Special Financing, Inc., was rated A2 by Moody's, A by S&P, and AA+ by Fitch for unsecured long-term debt.

The University receives the SIFMA from Lehman Brothers and pays a floating rate to its bondholders set by the Remarketing Agent. The University incurs basis risk when its bonds begin to trade at a yield above the SIFMA index. Basis risk also exists since swap payments are made quarterly while bond payments are made monthly. With the alternative tax structure of the swap, a change in tax law would trigger the swap being converted from a SIFMA swap to a percentage of LIBOR swap. This would introduce basis risk. If the weekly reset interest rates on the University's bonds are in excess of 65% of LIBOR, the University will experience an increase in debt service above the fixed rate on the swap to the extent that the interest rates on the bonds exceed 65% of LIBOR.

The swap agreement uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. Termination could result in the University being required to make an unanticipated termination payment. The swap terminates if the University or Lehman Brothers fails to perform under terms of the contract.

Wachovia

The University entered into an interest rate swap agreement with Wachovia on December 5, 2006, based on a notional amount of \$100,000,000, effective December 1, 2007, maturing on December 1, 2036. This transaction serves as a hedge of variable interest rates on a portion of the General Revenue 2001 B&C bonds and the outstanding commercial paper bonds.

Under the agreement, Wachovia pays the University 67% of the one-month LIBOR index times the notional amount, payable monthly. The University pays Wachovia a fixed rate of 3.314% on the notional amount,

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

payable monthly. The effective date of this swap was December 1, 2007. As of June 30, 2009, rates were as follows:

	Terms	Rate
Fixed Payment to Wachovia	Fixed	3.314%
Variable Payment from Wachovia	LIBOR	0.213%
Net Interest Rate Swap Payments		3.101%
Weighted Average Variable Rates		0.003%
Synthetic Interest Rate on Bonds		3.104%

As of June 30, 2009, the swap had a fair negative value of \$10,079,658. The fair value was developed by Wachovia. Market value represents the amount that would be paid to (or received from) another swap dealer to assume the payments under the swap.

As of June 30, 2009, the University was not exposed to credit risk because the swap had a negative fair value. In the event that the swap carried a positive fair value for the University and in the event of a specified ratings downgrade of Wachovia's unsecured long-term debt, Wachovia would be required to post collateral in the amount of the difference between the positive fair value of the swap and the thresholds in the below tables. The University is also subject to the same provisions. Wachovia was rated AA by S&P, AA- by Fitch and Aa2 by Moody's.

Ratings Moody's/S&P/ Fitch	Threshold
Aa3/AA- or above	\$Infinity
A1/A+	\$15,000,000
A2/A	\$10,000,000
A3/A- or below	\$0

Changes in swap interest rates and tax-exempt bond interest rates may differ, introducing basis risk in the event the swap is unwound and traditional fixed-rate debt is issued. In the event that the University issues variable rate debt to create synthetic fixed rate debt, the University will be paying a rate on the bonds that may not correlate with 67% of the one-month LIBOR index, altering the "fixed" cost of synthetic debt.

The swap agreement uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. Termination could result in the University being required to make an unanticipated termination payment. The swap

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

terminates if the University or Wachovia fails to perform under terms of the contract.

Future Swaps:

The University entered into an interest rate swap agreement with the Bank of New York for \$150,000,000 to be effective December 1, 2009. The University has the option to (1) issue variable rate bonds in December 2009, thereby effectively creating synthetic fixed-rate debt, or (2) unwind the swap, capturing the value of the movement of interest rates from the issuance date and issuing traditional fixed rate bonds.

D. Capital Appreciation Bonds - The University's Series 1997 Utility System and the Series 1991 U.S. Environmental Protection Agency Project bond issues include capital appreciation bonds with an original issue amount of \$30,379,142 and \$3,828,921, respectively. These bonds are recorded in the amounts of \$56,664,193 (\$84,135,000 ultimate maturity less \$27,470,807 discount) and \$19,285,757 (\$25,275,000 ultimate maturity less \$5,989,243 discount), respectively, which is the accreted value at June 30, 2009. These bonds mature in the years 2015 to 2021.

E. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2009, are as follows:

Fiscal Year	Annual Requirements				
	Bonds Payable			Notes Payable	
	Principal	Interest	Interest Rate Swaps, Net*	Principal	Interest
2010	\$ 24,470,000	\$ 42,383,999	\$ 990,642	\$ 675,000	\$ 669
2011	24,905,000	41,635,415	976,005		
2012	25,530,000	40,835,024	960,753		
2013	25,860,000	40,231,159	933,816		
2014	24,705,000	39,851,252	894,333		
2015-2019	113,560,000	192,971,876	3,791,844		
2020-2024	112,515,000	181,020,920	2,090,508		
2025-2029	135,915,000	157,751,798	203,073		
2030-2034	336,500,000	112,681,956			
2035-2039	232,820,000	14,207,125			
Total Requirements	\$ 1,056,780,000	\$ 863,570,524	\$ 10,840,974	\$ 675,000	\$ 669

Interest on the variable rate General Revenue Bonds 2001B is calculated at 0.17% at June 30, 2009.

Interest on the variable rate General Revenue Bonds 2001C is calculated at 0.15% at June 30, 2009.

Interest rates are reset each week by the remarketing agent based upon a combination of the University's credit rating and market conditions.

This schedule also includes the debt service requirements for debt associated with interest rate swaps. More detailed information about interest rate swaps is presented in Note 8C.

*Computed using $(5.24\% - 0.32) \times (\$22,000,000 - \text{annual swap reduction})$

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- F. Bond Defeasance** - During the prior years, the University extinguished long-term debt obligations by the issuance of new long-term debt instruments as follows:

Student Union: On August 30, 2005, the University defeased \$8,750,000 of outstanding Student Fee Revenue Bonds, Series 2000. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the Statement of Net Assets. At June 30, 2009, the outstanding balance of the defeased Student Fee Revenue Bonds, Series 2000 bonds was \$8,750,000.

General Revenue Bonds, Series 2001A: On August 30, 2005, the University defeased \$33,310,000 of outstanding General Revenue Bonds, Series 2001A. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the Statement of Net Assets. At June 30, 2009, the outstanding balance of the defeased General Revenue Bonds, Series 2001A bonds was \$33,310,000.

- G. Notes Payable** - The University was indebted for notes payable for the purposes shown in the following table:

Purpose	Financial Institution	Interest Rate	Final Maturity Date	Beginning Balance July 1, 2008	Draws	Repayments	Principal Outstanding June 30, 2009
Real Property Purchases	Bank of America	0.595%	08/30/09	\$ 1,037,000	\$ 0	\$ 362,000	\$ 675,000

The UNC-Chapel Hill Foundation, part of the University's reporting entity, has a line of credit agreement issued by Bank of America, originally in the aggregate principal amount up to \$10,000,000 to finance the costs of projects benefiting the foundation or the University. The line of credit had a maturity date of June 30, 2009 but subsequent to year end was extended to August 30, 2009. The aggregate principal amount remained at \$6,000,000. Advances under the line of credit accrue interest at the variable rate of the LIBOR Market Index plus 0.275%. An unused commitment fee is due each quarter calculated as 0.25% of the difference between the commitment amount and the average balance outstanding for the quarter through June 30, 2005, and 0.215% thereafter. The University repays draws on the note with capital improvement funds designated for land acquisition.

- H. Annuities Payable** - The University participates in split-interest agreements with donors that require benefits payments for a specified

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

period to a designated beneficiary out of assets held in trust for this purpose. At the end of the predetermined period (e.g., the lifetime of the beneficiary specified by the donor), the remaining assets of the trust revert to the University for its use or for a purpose specified by the donor. At the end of each fiscal year, annuities and life income payable to the beneficiaries is calculated using IRS issued 90CM table, taking into consideration beneficiary's age and the amount of the gift, and using IRS issued Life Table 90CM.

NOTE 9 - LEASE OBLIGATIONS

- A. Capital Lease Obligations** - Capital lease obligations relating to medical and research equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2009:

<u>Fiscal Year</u>	<u>Amount</u>
2010	\$ 853,135
2011	541,528
2012	503,887
2013	42,559
Total Minimum Lease Payments	1,941,109
Amount Representing Interest (0.14% - 44.51% Rate of Interest)	230,967
Present Value of Future Lease Payments	\$ 1,710,142

Machinery and equipment acquired under capital lease amounted to \$3,745,834 at June 30, 2009.

- B. Operating Lease Obligations** - Future minimum lease payments under non-cancelable operating leases consist of the following at June 30, 2009:

<u>Fiscal Year</u>	<u>Amount</u>
2010	\$ \$7,153,693
2011	4,790,425
2012	1,784,616
2013	922,065
2014	71,455
2015-2019	68,615
Total Minimum Lease Payments	\$ \$14,790,869

Rental expense for all operating leases during the year was \$12,608,769.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

C. Other Lease Obligations – The UNC-Chapel Hill Foundation issued certificates of participation to provide for construction of alumni facilities. The University constructed the facilities as an agent for the UNC-Chapel Hill Foundation. In October 1989, the University entered into a 20-year lease agreement with the UNC-Chapel Hill Foundation and simultaneously entered into a sublease agreement with the General Alumni Association, an affiliated organization, for the same time period for the use of the alumni facilities. Legal interpretation of the sublease agreement assigned the debt obligation to the General Alumni Association.

Payments under the terms of the lease are a limited obligation of the University, payable solely from and secured by the annual rental income derived from the sublease of the alumni facilities. The University has no other obligations for repayment of the certificates of participation; therefore, the certificates are not reported as a liability in the accompanying financial statements. As of June 30, 2009, the aggregate principal amount of the certificates was \$9,950,000.

If the University complies with all the terms of the lease agreement, title to the alumni facilities will be conveyed to the University.

NOTE 10 - REVENUES

A summary of eliminations and allowances by revenue classification is presented as follows:

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Change in Allowance for Uncollectibles	Less Indigent Care and Contractual Adjustments	Net Revenues
Operating Revenues						
Student Tuition and Fees	\$ 300,427,637	\$ 0	\$ 63,467,416	\$ 0	\$ 0	\$ 236,960,221
Patient Services	\$ 571,360,106	\$ 0	\$ 0	\$ (11,962,978)	\$ 345,356,969	\$ 237,966,115
Sales and Services						
Residential Life	\$ 45,887,928	\$ 0	\$ 9,226,654	\$ 0	\$ 0	\$ 36,661,274
Dining	24,902,746					24,902,746
Student Union Services	619,670	609,820				9,850
Health, Physical Education, and Recreation Services	5,756,908	300	240,265			5,516,343
Bookstore	28,294,933	3,266,093	726,943			24,301,897
Parking	21,583,719	112				21,583,607
Athletic	49,713,596	22,202				49,691,394
Utilities	120,155,505	92,475,893	898			27,678,714
Telecommunications	18,755,464	14,587,368				4,168,096
Other Professional Income	81,246,190	5,555,518				75,690,672
Printing/Carolina Copy	7,986,151	4,948,916				3,037,235
Repairs & Maintenance	33,625,115	32,346,630				1,278,485
Materials Management and Disbursements	24,075,707	24,005,656				70,051
Rental Property	6,177,187	525,124				5,652,063
Carolina Living & Learning Center	2,877,152					2,877,152
Performing Arts Series	1,573,088	27,901				1,545,187
Snack Bars	1,428,266	16,870				1,411,396
Other	83,125,206	47,696,364				35,428,842
Total Sales and Services	\$ 557,784,531	\$ 226,084,767	\$ 10,194,760	\$ 0	\$ 0	\$ 321,505,004
Nonoperating - Noncapital Gifts	\$ 87,482,393	\$ 0	\$ 0	\$ 256,319	\$ 0	\$ 87,226,074

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 11 - OPERATING EXPENSES BY FUNCTION

The University's operating expenses by functional classification are presented as follows:

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 526,040,031	\$ 24,713,324	\$ 124,037,046	\$ 0	\$ 151,849	\$ 0	\$ 674,942,250
Research	242,092,222	45,162,450	111,097,254		401,537		398,753,463
Public Service	57,577,974	9,598,629	59,143,720		107,131		126,427,454
Academic Support	81,878,852	9,375,144	15,995,185		122,001		107,371,182
Student Services	13,829,106	862,622	13,274,953		521		27,967,202
Institutional Support	62,132,287	5,195,700	22,597,166		28,427		89,953,580
Operations and Maintenance of Plant	46,995,796	12,594,854	19,394,062		66,564,792		145,549,504
Student Financial Aid				58,557,246			58,557,246
Auxiliary Enterprises	279,315,479	66,998,654	167,483,089		10,259,501		524,056,723
Depreciation						70,747,110	70,747,110
Total Operating Expenses	<u>\$ 1,309,861,747</u>	<u>\$ 174,501,377</u>	<u>\$ 533,022,475</u>	<u>\$ 58,557,246</u>	<u>\$ 77,635,759</u>	<u>\$ 70,747,110</u>	<u>\$ 2,224,325,714</u>

NOTE 12 - PENSION PLANS

A. Retirement Plans - Each permanent full-time employee, as a condition of employment, is a member of either the Teachers' and State Employees' Retirement System or the Optional Retirement Program. Eligible employees can elect to participate in the Optional Retirement Program at the time of employment, otherwise they are automatically enrolled in the Teachers' and State Employees' Retirement System.

The Teachers' and State Employees' Retirement System is a cost-sharing multiple-employer defined benefit pension plan established by the State to provide pension benefits for employees of the State, its component units and local boards of education. The plan is administered by the North Carolina State Treasurer.

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2009, these rates were set at 3.36% of covered payroll for employers and 6% of covered payroll for members.

For the current fiscal year, the University had a total payroll of \$1,121,986,960, of which \$468,941,991 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$15,756,451 and \$28,136,519, respectively.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Required employer contribution rates for the years ended June 30, 2008, and 2007, were 3.05% and 2.66%, respectively, while employee contributions were 6% each year. The University made 100% of its annual required contributions for the years ended June 30, 2009, 2008, and 2007, which were \$15,756,451, \$13,032,159, and \$10,668,088, respectively.

The Teachers' and State Employees' Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Proceed directly to OSC's index page," then "Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators and eligible faculty of the University may join the Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of The University of North Carolina is responsible for the administration of the Program and designates the companies authorized to offer investment products or the trustee responsible for the investment of contributions under the Program and approves the form and contents of the contracts and trust agreements.

Participants in the Program are immediately vested in the value of employee contributions. The value of employer contributions is vested after five years of participation in the Program. Participants become eligible to receive distributions when they terminate employment or retire.

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 2009, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The University assumes no liability other than its contribution.

For the current fiscal year, the University had a total payroll of \$1,121,986,960, of which \$456,817,602 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$31,246,324 and \$27,409,056, respectively.

B. Deferred Compensation and Supplemental Retirement Income Plans - IRC Section 457 Plan - The State of North Carolina offers its permanent

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$7,019,689 for the year ended June 30, 2009.

IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the University except for a 5% employer contribution for the University's law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of University law enforcement officers for the year ended June 30, 2009, were \$138,675. The voluntary contributions by employees amounted to \$3,609,663 for the year ended June 30, 2009.

IRC Section 403(b) and 403(b)(7) Plans - Eligible University employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and State income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$24,632,827 for the year ended June 30, 2009.

NOTE 13 - OTHER POSTEMPLOYMENT BENEFITS

- A. **Health Benefits** - The University participates in the Comprehensive Major Medical Plan (the Plan), a cost-sharing, multiple-employer defined

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

benefit health care plan that provides postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. Coverage eligibility varies depending on years of contributory membership service in their retirement system prior to disability or retirement.

The Plan's benefit and contribution provisions are established by *North Carolina General Statute 135-7* and Chapter 135, Article 3A, of the General Statutes and may be amended only by the North Carolina General Assembly. The Plan does not provide for automatic post-retirement benefit increases.

By General Statute, a Retiree Health Benefit Fund (the Fund) has been established as a fund in which accumulated contributions from employers and any earnings on those contributions shall be used to provide health benefits to retired and disabled employees and applicable beneficiaries. By statute, the Fund is administered by the Board of Trustees of the Teachers' and State Employees' Retirement System and contributions to the fund are irrevocable. Also by law, Fund assets are dedicated to providing benefits to retired and disabled employees and applicable beneficiaries and are not subject to the claims of creditors of the employers making contributions to the Fund. Contribution rates to the Fund, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are determined by the General Assembly in the Appropriations Bill.

For the current fiscal year the University contributed 4.1% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the Fund. Required contribution rates for the years ended June 30, 2008, and 2007, were 4.1% and 3.8%, respectively. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2009, 2008, and 2007, which were \$37,956,143, \$34,676,317, and \$29,918,690, respectively. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Proceed directly to OSC's index page," then "Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

B. Disability Income - The University participates in the Disability Income Plan of North Carolina (DIPNC), a cost-sharing, multiple-employer defined benefit plan, to provide short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program. Benefit and contribution provisions are established by Chapter 135, Article 6, of the General Statutes, and may be amended only by the North Carolina General Assembly. The plan does not provide for automatic post-retirement benefit increases.

Disability income benefits are funded by actuarially determined employer contributions that are established in the Appropriations Bill by the General Assembly. For the fiscal year ended June 30 2009, the University made a statutory contribution of .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2008, and 2007, were .52% and .52%, respectively. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2009, 2008, and 2007, which were \$4,813,950, \$4,397,972, and \$4,094,137, respectively. The University assumes no liability for long-term disability benefits under the Plan other than its contribution.

Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 14 - RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, including participation in State-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

Public Officer's and Employee's Liability Insurance - Tort claims of up to \$1,000,000 are retained under the authority of the State Tort Claims Act. In addition, the state provides excess public officers' and employees' liability insurance up to \$10,000,000 through a contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

System Fund (blended component unit) Liability Insurance – The System Fund is exposed to various risks of loss related to torts, theft of assets, and errors and omissions. The Management Company is a separate legal entity from The University of North Carolina System and the University. However, the Management Company’s employees conduct System Fund’s affairs. Therefore, exposures to loss are handled by the purchase of commercial insurance by the Management Company. This insurance is independent of the risk management programs of The University of North Carolina System and the University.

Fire and Other Property Loss - The University is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the University for operations supported by the State’s General Fund. Other operations not supported by the State’s General Fund are charged for the coverage. Fire and lightning losses covered by the Fund are subject to a \$5,000 per occurrence deductible. The University also purchases through the Fund extended coverage for all campus buildings and contents with a \$500,000 per occurrence deductible. This extended coverage provides insurance against an additional set of perils, most notably for windstorms.

Automobile Liability Insurance - All State-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses are \$1,000,000 per claim and \$10,000,000 per occurrence. The University pays premiums to the North Carolina Department of Insurance for the coverage.

Employee and Computer Fraud - The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence. The private insurance company pays 90% of each loss less a \$75,000 deductible.

Other authorized coverage not handled by the North Carolina Department of Insurance is purchased through the State’s insurance agent of record. Examples include, but are not limited to, fine arts, boiler and machinery, medical professional liability, athletic accident and revenues, and study abroad health insurance.

Comprehensive Major Medical Plan - University employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the State Health Plan (Plan), a pension and other employee benefit trust fund of the State of North Carolina. The Plan has contracted with third parties to process claims.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The North Carolina Workers' Compensation Program provides benefits to workers injured on the job. All employees of the State and its component units are included in the program. When an employee is injured, the University's primary responsibility is to arrange for and provide the necessary treatment for work related injury. The University is responsible for paying medical benefits and compensation in accordance with the North Carolina Workers' Compensation Act. The University retains the risk for workers' compensation.

Liability Insurance Trust Fund - The University participates in the Liability Insurance Trust Fund (Trust Fund), a claims-servicing public entity risk pool for healthcare professional liability protection. The Trust Fund services professional liability claims, managing separate accounts for each participant from which the losses of that participant are paid. Although participant assessments are determined on an actuarial basis, ultimate liability for claims remains with the participants and, accordingly, the insurance risks are not transferred to the Trust Fund.

The Trust Fund is an unincorporated entity created by Chapter 116, Article 26, of the *North Carolina General Statutes* and The University of North Carolina Board of Governors Resolution of June 9, 1978. The Trust Fund is a self-insurance program established to provide professional medical malpractice liability covering The University of North Carolina Hospitals at Chapel Hill (UNC Hospitals) and The University of North Carolina at Chapel Hill Physicians and Associates (UNC P&A), the program participants. The Trust Fund provides coverage for program participants and individual health care practitioners working as employees, agents, or officers of program participants. The Trust Fund is exempt from federal and state income taxes, and is not subject to regulation by the North Carolina Department of Insurance.

Participation in the Trust Fund is open to the University of North Carolina, any constituent institution of the University of North Carolina, the UNC Hospitals, and any health-care institution, agency or entity that has an affiliation agreement with the University of North Carolina, with a constituent institution of the University of North Carolina, or with the UNC Hospitals. Only the UNC P&A and the UNC Hospitals have participated in the Trust Fund to date. Participants provide management and administrative services to the Trust Fund at no cost.

The Trust Fund is governed by the Liability Insurance Trust Fund Council (the Council). The Council consists of thirteen members as follows: one member each appointed by the State Attorney General, the State Auditor, the State Insurance Commissioner, the Director of the Office of State Budget and Management, the State Treasurer, (each serving at the pleasure of the appointer); and eight members appointed to three-year terms (with no limit on the number of terms) by the UNC System's Board of Governors.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Trust Fund establishes claim liabilities based on estimates of the ultimate cost of claims (including future expenses and claim adjustment expenses) that have been reported but not settled and of claims incurred but not reported. Claim liabilities are recomputed annually based on an independent actuary's study to produce current estimates that reflect recent settlements, claims frequency, inflation, and other factors. Participant assessments are determined at a level to fund claim liabilities, discounted for future investment earnings. Each participant is required by statute to maintain a fund balance of \$100,000 at all times. Participants are subject to additional premium assessments in the event of deficiencies.

For the period July 1, 2008 through June 30, 2009, the Trust Fund provided coverage on an occurrence basis of \$3,000,000 per individual and \$7,000,000 in the aggregate per claim. Effective July 1, 2006, in lieu of purchasing commercial reinsurance, participants contributed approximately \$10,000,000 to a reimbursement fund for future losses. Prior to July 1, 2006, the Trust Fund entered into an excess of loss agreement with an unaffiliated reinsurer.

For the fiscal year ending June 30, 2009, the Trust Fund purchased a direct insurance policy to cover the first \$1,000,000 per occurrence and \$3,000,000 in the aggregate for dental residents. North Carolina General Statutes Chapter 116 was amended during 1987 to authorize the Trust Fund to borrow necessary amounts up to \$30,000,000, in the event that the Trust Fund may have insufficient funds to pay existing and future claims. Any such borrowing would be repaid from the assets and revenues of program participants. No line of credit or borrowing has been established pursuant to this authorization. The Council believes adequate funds are on deposit in the Trust Fund to meet estimated losses based upon the results of the independent actuary's report.

The Trust Fund has purchased annuity contracts to settle claims for which the claimant has signed an agreement releasing the Fund from further obligation. The related claim liabilities have been removed from estimated malpractice costs.

The Council may choose to terminate the Trust Fund, or the respective participants may choose to terminate their participation. In the event of such termination by either the Council or a participant, an updated actuarial study will be performed to determine amounts due to or from the participants based on loss experience up to the date of termination.

At June 30, 2009, University assets in the Trust Fund totaled \$36,212,736 while University liabilities totaled \$25,542,882 resulting in net assets of \$10,669,854.

Additional disclosures about the funding status and obligations of the Trust Fund are set forth in the Audited Financial Statements of the Liability

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Insurance Trust Fund for the years ended June 30, 2009 and 2008. Copies of this report may be obtained from The University of North Carolina Liability Insurance Trust Fund, 4030 Bondurant Hall, CB# 7000, Chapel Hill, North Carolina 27599-7000, or by calling (919) 966-1712.

Term life insurance (death benefits) of \$25,000 to \$50,000 is provided to eligible workers. This Death Benefit Plan is administered by the State Treasurer and funded via employer contributions. The employer contribution rate was 0.16 % for the current fiscal year.

Additional details on the State-administered risk management programs are disclosed in the State's *Comprehensive Annual Financial Report*, issued by the Office of the State Controller.

NOTE 15 - COMMITMENTS AND CONTINGENCIES

- A. Commitments** - The University has commitments of \$146,124,122 for various capital improvements projects that include construction and completion of new buildings, and renovations of existing buildings. The UNC Investment Fund, LLC (System Fund) has entered into agreements with limited partnerships, where the fund agrees to commit capital to these investments. As of June 30, 2009, the System Fund has \$495 million committed capital not yet called.
- B. Pending Litigation and Claims** - The Supreme Court of North Carolina issued a ruling on July 1, 2005 regarding litigation between North Carolina School Boards Association, et. al. v. Richard H. Moore, State Treasurer, et. al. which involves various state officials in their official capacity seeking a judicial determination as to whether the state constitution requires certain monetary payments collected by state agencies to be paid to the local county school funds rather than statutorily designated recipients. The complaint alleged in part that the monetary payments collected pursuant to statutory authority by the University for violations of parking and traffic regulations and library fines are "civil penalties" which the state constitution requires to be paid to the school fund in the county where they are collected. The lawsuit sought declaratory judgment that the State Civil Penalty and Forfeiture Fund, the State School Technology Fund, and the Public Settlement Reserve Fund are unconstitutional. The North Carolina Supreme Court affirmed the Court of Appeals ruling that library fines are not civil penalties. The North Carolina Supreme Court reversed the ruling that fines for parking and traffic regulations are not civil penalties.

The University of North Carolina at Chapel Hill, a constituent university of the UNC System, has collected \$10,097,719 representing net fines

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

from the Department of Public Safety from January 1, 1996 through June 30, 2005. Of that amount 10% may be retained by the University to fund related operating expenses. Therefore, approximately \$9,087,947 may be payable by the University. Collected fines of \$3,587,768 remain unexpended. Annual fines are approximately \$850,000. Fines net of approved operating expenses have been remitted to the State Treasurer on a monthly basis beginning July 1, 2005.

On August 8, 2008 a ruling was made by the Superior Court Division resulting in a judgment entered against the UNC System for \$42,368,982 to be paid into the Civil Penalty and Forfeiture Fund for distribution to the public schools pursuant to G.S. 115C-457.1 and Article IX, Section 7 of the North Carolina Constitution. Settlement of the obligation is being facilitated by the General Assembly.

In January of 2009, the plaintiffs filed a Motion for Additional Relief with the court requesting that the plaintiffs be paid \$18,183,251 that the various University campuses have placed in escrow from 2001 through 2005. The University of North Carolina at Chapel Hill's share of that \$18,183,251 is \$3,907,525. The plaintiff's motion was heard and denied. The plaintiffs have appealed the denial, and the matter is now before the Court of Appeals.

On August 7, 2009, the General Assembly of North Carolina enacted Session Law 2009-451, Section 5.1.(b) requiring that all University of North Carolina campuses remit all parking fines held in escrow in the amount of \$18,183,251 to the Civil Penalty and Forfeiture Fund for appropriation. The University recorded a liability of \$3,907,525 at June 30, 2009 for its share of the total amount.

The University is undertaking environmental remediation efforts on the Old Sanitary Landfill. The amount of the liability associated with this site cannot reasonably be estimated at this time.

The University is a party to other litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management believes that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.

- C. Other Contingent Receivables** – The University has received notification of other gifts and grants for which funds have not been disbursed by the resource provider and for which conditions attached to the gift or grant have not been satisfied or, in the case of permanent endowments, cannot begin to be satisfied. In accordance with accounting

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

principles generally accepted in the United States of America, these amounts have not been recorded on the accompanying financial statements. The purpose and amount of other contingent receivables at year-end is as follows:

<u>Purpose</u>	<u>Amount</u>
Pledges to permanent endowments	<u>\$ 32,822,490</u>

NOTE 16 - RELATED PARTIES

There are 13 separately incorporated nonprofit foundations associated with the University. These foundations are the Botanical Garden Foundation, Inc., The Dental Alumni Association, Inc., The Dental Foundation of North Carolina, Inc., The Educational Foundation, Inc., The General Alumni Association, The School of Government Foundation, Inc., The Morehead Scholarship Foundation, Inc., The Pharmacy Foundation of North Carolina, Inc., The School of Journalism and Mass Communication Foundation of North Carolina, Inc., The University of North Carolina at Chapel Hill Public Health Foundation, Inc., The University of North Carolina at Chapel Hill School of Nursing Foundation, Inc., The School of Social Work Foundation, Inc., and Carolina for Kibera, Inc. Some of these organizations serve, in conjunction with the University's component units (See Note 1A), as the primary fundraising arm of the University through which individuals, corporations, and other organizations support University programs by providing scholarships, fellowships, faculty salary supplements, and unrestricted funds to specific colleges and the University's overall academic environment. The alumni associations provide educational opportunities or other services to alumni. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of these organizations, except for support from each organization to the University. This support totaled \$15,002,149 for the year ended June 30, 2009.

NOTE 17 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2009, the University implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 49, Accounting and Financial Reporting for Pollution Remediation Obligations.

GASB Statement No. 52, Land and Other Real Estate Held as Investments by Endowments.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

GASB Statement No. 49, requires reporting pollution remediation obligations, including reporting pollution remediation obligations that previously may not have been reported.

GASB Statement No. 52, requires reporting land and other real estate held as investments at fair value. This statement amends GASB Statement No. 31 which required endowments to report land and other real estate investments at historical cost.

In addition, beginning with the year ended June 30, 2009, the University reports federal student aid as nonoperating revenue instead of operating revenue. This change was the result of a clarification in the GASB *Comprehensive Implementation Guide*.

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

NOTE 18 - SUBSEQUENT EVENTS

On July 1, 2009, The University of North Carolina at Chapel Hill Foundation, Inc. and Chapel Hill Foundation Real Estate Holdings, Inc. signed a promissory note with Bank of America, N.A., for \$45,750,000 to purchase University Square and Granville Towers. These properties, formerly privately owned, consist of student residence halls, leased retail space, leased office space, and surface parking lots and are located in close proximity to the University campus in downtown Chapel Hill.

On December 2, 2009, the Board of Governors of the University of North Carolina System issued \$210,540,000 of General Revenue Bonds. The bonds refunded \$104,857,588 of outstanding commercial paper.



Beth A. Wood, CPA
State Auditor

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**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Board of Trustees
The University of North Carolina at Chapel Hill
Chapel Hill, North Carolina

We have audited the financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2009, which collectively comprise the University's basic financial statements and have issued our report thereon dated December 8, 2009. Our report was modified to include a reference to other auditors.

As discussed in Note 17 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* and Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, during the year ended June 30, 2009.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the discretely presented component units, as described in our report on the University's financial statements. The financial statements of the discretely presented component units were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS (CONCLUDED)**

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the University's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the University's financial statements that is more than inconsequential will not be prevented or detected by the University's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the University's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management of the University, the Board of Governors, the Board of Trustees, the Audit Committee, others within the entity, the Governor, the General Assembly, and the State Controller, and is not intended to be and should not be used by anyone other than these specified parties.



Beth A. Wood, CPA
State Auditor

December 8, 2009

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